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ANALYSIS OF CASES PERTAINING TO THE INSOLVENCY AND BANKRUPTCY CODE, 2016—VOLUME 221

POORNIMA (N.)[1]

Avoidance of preferential transaction

Section 43 of the Insolvency and Bankruptcy Code, 2016, deals with preferential transaction and reads as under :

"*Preferential transactions and relevant time.*—(1) Where the liquidator or the resolution professional, as the case may be, is of the opinion that the corporate debtor has at a relevant time given a preference in such transactions and in such manner as laid down in sub-section (2) to any persons as referred to in sub-section (4), he shall apply to the Adjudicating Authority for avoidance of preferential transactions and for, one or more of the orders referred to in section 44.

(2) A corporate debtor shall be deemed to have given a preference, if—

(a) there is a transfer of property or an interest thereof of the corporate debtor for the benefit of a creditor or a surety or a guarantor for or on account of an antecedent financial debt or operational debt or other liabilities owed by the corporate debtor ; and

(b) the transfer under clause (a) has the effect of putting such creditor or a surety or a guarantor in a beneficial position than it would have been in the event of a distribution of assets being made in accordance with section 53.

(3) For the purposes of sub-section (2), a preference shall not include the following transfers—

1. B.Com, LL.B, Consultant.

(a) transfer made in the ordinary course of the business or financial affairs of the corporate debtor or the transferee ;

(b) any transfer creating a security interest in property acquired by the corporate debtor to the extent that—

(i) such security interest secures new value and was given at the time of or after the signing of a security agreement that contains a description of such property as security interest, and was used by corporate debtor to acquire such property ; and

(ii) such transfer was registered with an information utility on or before thirty days after the corporate debtor receives possession of such property :

Provided that any transfer made in pursuance of the order of a court shall not, preclude such transfer to be deemed as giving of preference by the corporate debtor.

Explanation.—For the purpose of sub-section (3) of this section, 'new value' means money or its worth in goods, services, or new credit, or release by the transferee of property previously transferred to such transferee in a transaction that is neither void nor voidable by the liquidator or the resolution professional under this Code, including proceeds of such property, but does not include a financial debt or operational debt substituted for existing financial debt or operational debt.

(4) A preference shall be deemed to be given at a relevant time, if—

(a) it is given to a related party (other than by reason only of being an employee), during the period of two years preceding the insolvency commencement date ; or

(b) a preference is given to a person other than a related party during the period of one year preceding the insolvency commencement date."

In *Anuj Jain, Interim Resolution Professional for Jaypee Infratech Ltd.* v. *Axis Bank Ltd.* [2020] 221 Comp Cas 625 (SC), the Supreme Court extensively considered the provisions of relating to preferential transaction in the Companies Act, 1956, Companies Act, 2013 and the Code. On facts of the case it was held that mortgage of property of corporate debtor to secure debt offered to its holding company was a preferential transaction especially when the corporate debtor had been declared as a non-performing asset and was under heavy pressure to honour its commitments and that such creditor could not be called as a "financial creditor". The decision of

the Appellate Tribunal in *Axis Bank Ltd.* v. *Anuj Jain, Resolution Professional for Jaypee Infratech Ltd.* [2020] 221 Comp Cas 590 (NCLAT) was reversed. The salient points from this important judgment are extracted below :

(i) *Relevant time under section 43* : Provision cannot be retrospective merely because look-back period envisaged for purpose of finding "relevant time". Remortgage of corporate debtor's property to secure debts of its holding company was a fresh mortgage. The transactions entered into within two years prior to the relevant date deemed preference to related part by the corporate debtor and covered within period envisaged by section 43(4).

(ii) To avoid disqualification the transaction must be shown to have been entered into in the ordinary course of business. Creation of encumbrances over properties to secure debts of the holding company especially when the corporate debtor had been declared as a non-performing asset and was under heavy pressure to honour its commitments was not transaction entered into in ordinary course of business.

(iii) The word "or" occurring in the words "transfer in ordinary course of business or financial affairs of corporate debtor *"or"* "transferee" on a purposive interpretation must be read as "and". In page 703 of 221 Comp Cas, the Supreme Court has observed that :

> ". . . the purport of clause (a) of sub-section (3) of section 43 is also principally directed towards the corporate debtor's dealings. In other words, the whole of conspectus of sub-section (3) is that only if any transfer is found to have been made by the corporate debtor, either in the ordinary course of its business or financial affairs or in the process of acquiring any enhancement in its value or worth, that might be considered as having been done without any tinge of favour to any person in preference to others and thus, might stand excluded from the purview of being preferential, subject to fulfilment of other requirements of sub-section (3) of section 43.
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> Needless to reiterate that if the transfer is examined with reference to the ordinary course of business or financial affairs of the transferee alone, it may conveniently get excluded from the rigour of sub-section (2) of section 43, even if not standing within the scope of ordinary course of business or financial affairs of the corporate debtor. Such had never been the scheme of the Code nor the intent of section 43 thereof. It has rightly been contended on behalf of the appellants that for the purpose of exception under clause (a) of sub-section (3) of section 43, the intent of Legislature is required to be kept in view. If

the ordinary course of business or financial affairs of the transferee (lenders of JAL in the present case) would itself be decisive for exclusion, almost every transfer made to the transferees like the lender-banks/financial institutions would be taken out of the net, which would practically result in frustrating the provision itself."

Duties of resolution professional : In pages 708 and 709 of 221 Comp Cas, the Supreme Court has enumerated the duties of the resolution professional when faced with a transaction that could be considered as "preferential" :

"Looking to the legal fictions created by section 43 and looking to the duties and responsibilities per section 25, in our view, for the purpose of application of section 43 of the Code in any insolvency resolution process, what a resolution professional is ordinarily required to do could be illustrated as follows :

(1) In the first place, the resolution professional shall have to take two major but distinct steps. One shall be of sifting through the entire cargo of transactions relating to the property or an interest thereof of the corporate debtor backwards from the date of commencement of insolvency and up to the preceding two years. The other distinct step shall be of identifying the persons involved in such transactions and of putting them in two categories ; one being of the persons who fall within the definition of 'related party' in terms of section 5(24) of the Code and another of the remaining persons.

(2) In the next step, the resolution professional ought to identify as to in which of the said transactions of preceding two years, the beneficiary is a related party of the corporate debtor and in which the beneficiary is not a related party. It would lead to bifurcation of the identified transactions into two sub-sets : One concerning related party/parties and other concerning unrelated party/parties with each sub-set requiring different analysis. The sub-set concerning unrelated party/parties shall further be trimmed to include only the transactions of preceding one year from the date of commencement of insolvency.

(3) Having thus obtained two sub-sets of transactions to scan, the steps thereafter would be to examine every transaction in each of these sub-sets to find : (i) as to whether the transaction is of transfer of property or an interest thereof of the corporate debtor ; and (ii) as to whether the beneficiary involved in the transaction stands in the capacity of creditor or surety or guarantor qua the corporate debtor. These steps shall lead to shortlisting of such transactions which carry the potential of being preferential.

(4) In the next step, the said shortlisted transactions would be scrutinised to find if the transfer in question is made for or on account of an antecedent financial debt or operational debt or other liability owed by the corporate debtor. The transactions which are so found would be answering to clause (a) of sub-section (2) of section 43.

(5) In yet further step, such of the scanned and scrutinised transactions that are found covered by clause (a) of sub-section (2) of section 43 shall have to be examined on another touchstone as to whether the transfer in question has the effect of putting such creditor or surety or guarantor in a beneficial position than it would have been in the event of distribution of assets per section 53 of the Code. If answer to this question is in the affirmative, the transaction under examination shall be deemed to be of preference within a relevant time, provided it does not fall within the exclusion provided by sub-section (3) of section 43.

(6) In the next and equally necessary step, the transaction which otherwise is to be of deemed preference, will have to pass through another filtration to find if it does not answer to either of clauses (a) and (b) of sub-section (3) of section 43.

(7) After the resolution professional has carried out the aforesaid volumetric as also gravimetric analysis of the transactions on the defined coordinates, he shall be required to apply to the Adjudicating Authority for necessary order/s in relation to the transaction/s that had passed through all the positive tests of sub-section (4) and sub-section (2) as also negative test of sub-section (3)."

Resolution plan

Review of resolution plan : The scope of judicial review of the decision of the committee of creditors approving or disapproving a resolution plan has been extensively discussed by the Supreme Court in *K. Sashidhar* v. *Indian Overseas Bank* [2019] 213 Comp Cas 356 (SC). The rulings of the Supreme Court at pages 396 and 397 are beneficial to understand the scope :

"Whereas, the discretion of the Adjudicating Authority (National Company Law Tribunal) is circumscribed by section 31 limited to scrutiny of the resolution plan 'as approved' by the requisite per cent. of voting share of financial creditors. Even in that enquiry, the grounds on which the Adjudicating Authority can reject the resolution plan is in reference to matters specified in section 30(2), when the resolution plan does not conform to the stated requirements. Reverting to section 30(2), the enquiry to be done is in respect of

whether the resolution plan provides : (i) the payment of insolvency resolution process costs in a specified manner in priority to the repayment of other debts of the corporate debtor, (ii) the repayment of the debts of operational creditors in prescribed manner, (iii) the management of the affairs of the corporate debtor, (iv) the implementation and supervision of the resolution plan, (v) does not contravene any of the provisions of the law for the time being in force, (vi) conforms to such other requirements as may be specified by the Board. The Board referred to is established under section 188 of the Code. The powers and functions of the Board have been delineated in section 196 of the Code. None of the specified functions of the Board, directly or indirectly, pertain to regulating the manner in which the financial creditors ought to or ought not to exercise their commercial wisdom during the voting on the resolution plan under section 30(4) of the Code. The subjective satisfaction of the financial creditors at the time of voting is bound to be a mixed baggage of variety of factors. To wit, the feasibility and viability of the proposed resolution plan and including their perceptions about the general capability of the resolution applicant to translate the projected plan into a reality. The resolution applicant may have given projections backed by normative data but still in the opinion of the dissenting financial creditors, it would not be free from being speculative. These aspects are completely within the domain of the financial creditors who are called upon to vote on the resolution plan under section 30(4) of the I and B Code.

For the same reason, even the jurisdiction of the National Company Law Appellate Tribunal being in continuation of the proceedings would be circumscribed in that regard and more particularly on account of section 32 of the I and B Code, which envisages that any appeal from an order approving the resolution plan shall be in the manner and on the grounds specified in section 61(3) of the I and B Code."

The Supreme Court considered residual jurisdiction of the Adjudicating Authority under section 60(5) of the Code to hold that such residual jurisdiction would not in any manner impact section 30(2) of the Code which circumscribed the jurisdiction of the Adjudicating Authority when it came to the confirmation of a resolution plan in terms of section 31 of the Code. It was made clear that there was no discretionary or equity jurisdiction in the Adjudicating Authority outside section 30(2) of the Code, when it comes to a resolution plan being approved by the Adjudicating Authority.

In the Supreme Court *Maharashtra Seamless Ltd.* v. *Padmanabhan Venkatesh* [2020] 9 Comp Cas-OL 683 (SC), directed the Adjudicating Authority to pass order under section 31 of the Code without granting unnecessary adjournments.

Thus, it is clear that the scope for judicial review is very limited.The Adjudicating Authority keeping in mind these precedents of the Supreme Court, approved a resolution plan which satisfied all the requirements in terms of section 31(1) of the Code. It was reiterated that the decision taken by the financial creditors fell within the ambit of its commercial and banking wisdom and was therefore, not to be interfered with. (*F. M. Hammerle Textiles Ltd., In re*) [2020] 221 Comp Cas 9 (NCLT))

Concessions and exemptions **:** A resolution plan which met with the requirements of section 30(2) of the Code and regulations 37, 38(1A) and 39 of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 was approved by the Adjudicating Authority. This order was challenged contending that the resolution applicant had sought several concessions and exemptions such as set off of brought forwarded losses and unabsorbed depreciation for computation of taxable profits under the Income-tax Act, 1961 and that the licence fee for the corporate insolvency resolution process period formed part of the insolvency resolution process costs and should have been paid in full. The Appellate Tribunal modifying the order of approval, clarified that set off of losses under the Income-tax Act, 1961 was subject to scrutiny by the Income-tax Department and the Code. The Appellate Tribunal required the resolution applicant to give an affidavit from the resolution applicant that he would be successfully completing the resolution plan whether or not he got the set off under the Income-tax Act. It was further clarified that the business was running on a "going concern basis" for the period as long as the corporate insolvency resolution process continued or they had handed over the building to the building owner whichever was earlier and it was to be restricted to his income-tax returns so far filed. And that these costs needed to be included in the costs of the corporate insolvency resolution process. (*Ravindra Beleyur* v. *Merchem Ltd*. [2019] 214 Comp Cas 69 (NCLT) partially modified in *M. R. Pradeep* v. *Ravindra Beleyur*. [2020] 221 Comp Cas 572 (NCLAT)).

Admission of section 7 petition

Effect of status quo order by High Court **:** In terms of section 7(5) of the Code when the Adjudicating Authority is satisfied that (i) the corporate debtor has committed default and (ii) no disciplinary proceedings are pending against the proposed resolution professional, it may by an order

admit the petition filed. What would be the effect of a status quo order passed by the High Court came up for consideration before the Adjudicating Authority in *Punjab National Bank* v. *Shree Sai Prakash Alloys Ltd. (No. 1)* [2020] 221 Comp Cas 55 (NCLT). A writ petition was filed by the concerned party before the High Court and the High Court passed an order instructing the parties to maintain status quo in the matter. Therefore, it was contended before the Adjudicating Authority the order of admission should not be pronounced during the pendency of the status quo order. The Adjudicating Authority held that the pronouncement of an order admitting a petition under section 7 of the Code could not be stayed merely on the ground that a writ petition had been filed before the High Court. It was of the view that an order to parties to maintain status quo in the matter would not be an impediment to passing of an order by the Adjudicating Authority as there were no direction to the Authority by the Supreme Court. In the absence of such specific order to the Tribunal, it held that pronouncement of the final orders was justified. The Adjudicating Authority admitted the petition under section 7 in *Punjab National Bank* v. *Shree Sai Prakash Alloys Ltd. (No. 2)* [2020] 221 Comp Cas 57 (NCLT). However, the Appellate Tribunal in *Sandeep Kumar Bhagat* v. *Punjab National Bank* [2020] 221 Comp Cas 62 (NCLAT), after considering various circumstances including the status quo order passed by the High Court, reversed the decision of the National Company Law Tribunal in *Punjab National Bank* v. *Shree Sai Prakash Alloys P. Ltd. (No. 2)* [2020] 221 Comp Cas 57 (NCLT) and remanded the matter for reconsideration.

Defective petition : The proposed insolvency resolution professional is required to give a declaration in prescribed Form 2 under the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016, that no disciplinary proceedings were pending against him. However, no such declaration in Form 2 was attached with the petition. The Appellate Tribunal was of the view that in terms of the first proviso to section 7(5) of the Code, the Adjudicating Authority should have issued notice to the petitioner to rectify the application within seven days. Since the Adjudicating Authority had not taken into consideration the statutory provision of sub-section (5)(a) of section 7 of the Code and passed the admission order, the admission order was set aside. (*Sandeep Kumar Bhagat* v. *Punjab National Bank* [2020] 221 Comp Cas 62 (NCLAT) reversed in *Punjab National Bank* v. *Shree Sai Prakash Alloys P. Ltd. (No. 2)* [2020] 221 Comp Cas 57 (NCLT)).

One-time settlement : The Appellate Tribunal also considered the fact that after acceptance of the one-time settlement proposal for settling the

dues, the creditor had received substantial amounts from the corporate debtor. After making default in payment in accordance with the settlement order the corporate debtor had paid rupees one crore to the creditor for renewing the one-time settlement. The creditor thereafter had revoked the offer to renew the settlement. The Tribunal was of the view that considering the prevailing economic scenario of the country and downfall in every business activity, it would be fit and proper to provide one more opportunity to the parties for considering the one-time settlement proposal in a fair, just, objective and dispassionate manner. The matter was to be remanded to the Adjudicating Authority to pass an order afresh.

Financial creditor : Definition

Director as financial creditor : A promoter or shareholder or director of the company could also be its creditor. A director has a status different than that of the creditor. A director can invoke his status as creditor of the corporate debtor in respect of an amount disbursed by him to settle the company's dues. The bank statements showed that the transactions had been made by him in favour of the Greater Noida Industrial Development Authority on behalf of the corporate debtor in terms of the resolution passed by the board of directors in its meeting dated September 1, 2015. The balance-sheets for the years ending 2015, 2016 and 2017 depicted borrowings from the directors, shareholders and related parties under the heading "short-term borrowings" to the tune of more than Rs. 9 crores. Even otherwise the Adjudicating Authority found that was overwhelming evidence placed on record to show that the amount as claimed "due and payable" was disbursed by the petitioner to the Authority on behalf of the corporate debtor. The Adjudicating Authority held that the financial creditor had disbursed money to the corporate debtor and the corporate debtor had committed default in repayment of the outstanding financial debt which exceeded the statutory limit of rupees one lakh. Thus, the petition was admitted. This decision in *Anurag Gupta* v. *B. K. Educational Services P. Ltd.* [2020] 221 Comp Cas 394 (NCLT) was affirmed in *Mukesh Kumar Agarwal* v. *Anurag Gupta* [2020] 221 Comp Cas 402 (NCLAT). The Appellate Tribunal held that since the creditor had advanced various sums to the corporate debtor to ease its liquidity crunch, thereby improving its economic prospects and to save the allotments by making direct payment to the Greater Noida Industrial Development Authority for the plot allotted in the name of corporate debtor, the amount deposited by the creditor fell within the ambit of "financial debt". Since the amount had not been paid back, and there was a default, the admission of the petition by the Adjudicating Authority was held to be proper.

Person in whose favour properties mortgaged : If the mortgagee, being a stakeholder in the mortgaged property, is left out of the corporate insolvency resolution process nobody knows how the mortgagee will deal with the properties since the mortgagee has an interest transferred in specific immovable properties in its favour. Hence, unless an opportunity is given to the mortgagee to be part of the committee of creditors and is made as a party to the process of approval or rejection of resolution plan, that will be a clear case of violation of natural justice. The main objective of the Code is resolution of the corporate debtor and selective exclusion of an important stakeholder may not auger well for the successful conduct of the corporate insolvency resolution process. A narrow, conventional and restricted interpretation of financial debt may lead to a situation which is diagonally opposite to the objective of the Code itself. Further, when no representation is given to the mortgagee in the committee of creditors the binding effect of the resolution plan may be in jeopardy when the mortgagee enters into litigation at the stage of approval of the resolution plan or thereafter. The Adjudicating Authority in *SREI Infrastructure Finance Ltd.* v. *Sterling International Enterprises Ltd.* [2020] 221 Comp Cas 580 (NCLT) held that the mortgage executed by the corporate debtor in favour of the applicant was a security interest as provided under section 3(31) of the Code and the applicant was a stakeholder whose rights would be affected vitally. The applicant being the mortgagee of properties of the corporate debtor, who had advanced loan to a third party, was a financial creditor of the corporate debtor. It was entitled to exercise voting rights under the Code for enabling the successful implementation of the corporate insolvency resolution process. The resolution professional was directed to collate the claim received from the applicant as a financial creditor and include the applicant in the committee of creditors. However, this view of the Adjudicating Authority did not get the approval of the Supreme Court in *Anuj Jain, Interim Resolution Professional for Jaypee Infratech Ltd.* v. *Axis Bank Ltd.* [2020] 221 Comp Cas 625 (SC). The Supreme Court reversing the decision of the Appellate Tribunal in *Axis Bank Ltd.* v. *Anuj Jain, Resolution Professional for Jaypee Infratech Ltd.* [2020] 221 Comp Cas 590 (NCLAT) held that a mortgage of property of the corporate debtor to secure debt offered to its holding company was neither towards any loan, facility or advance to corporate debtor nor towards protecting any facility or security of corporate debtor. It was held that the corporate debtor did not owe any "financial debt". Such a lender was not a "financial creditors" of the corporate debtor. In fact the transaction was held to be a preferential transaction. The

reasoning behind this conclusion of the Supreme Court can be seen in pages 744 and 745 of 221 Comp Cas extracted below :

> "Applying the fundamental principles to the definition occurring in section 5(8) of the Code, we have not an iota of doubt that for a debt to become 'financial debt' for the purpose of Part II of the Code, the basic elements are that it ought to be a disbursal against the consideration for time value of money. It may include any of the methods for raising money or incurring liability by the modes prescribed in sub-clauses (a) to (f) of section 5(8) ; it may also include any derivative transaction or counter-indemnity obligation as per sub-clauses (g) and (h) of section 5(8) ; and it may also be the amount of any liability in respect of any of the guarantee or indemnity for any of the items referred to in sub-clauses (a) to (h). *The requirement of existence of a debt, which is disbursed against the consideration for the time value of money, in our view, remains an essential part even in respect of any of the transactions/dealings stated in sub-clauses (a) to (i) of section 5(8), even if it is not necessarily stated therein* (emphasis[1] supplied). In any case, the definition, by its very frame, cannot be read so expansive, rather infinitely wide, that the root requirements of 'disbursement' against 'the consideration for the time value of money' could be forsaken in the manner that any transaction could stand alone to become a financial debt. In other words, any of the transactions stated in the said sub-clauses (a) to (i) of section 5(8) would be falling within the ambit of 'financial debt' only if it carries the essential elements stated in the principal clause or at least has the features which could be traced to such essential elements in the principal clause. In yet other words, the essential element of disbursal, and that too against the consideration for time value of money, needs to be found in the genesis of any debt before it may be treated as 'financial debt' within the meaning of section 5(8) of the Code. This debt may be of any nature but a part of it is always required to be carrying, or corresponding to, or at least having some traces of disbursal against consideration for the time value of money.
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> As noticed, the root requirement for a creditor to become financial creditor for the purpose of Part II of the Code, there must be a financial debt which is owed to that person. He may be the principal creditor to whom the financial debt is owed or he may be an assignee in terms of extended meaning of this definition but, and nevertheless, the requirement of existence of a debt being owed is not forsaken.

1. Here printed in italics.

It is also evident that what is being dealt with and described in section 5(7) and in section 5(8) is the transaction vis-a-vis the corporate debtor. Therefore, for a person to be designated as a financial creditor of the corporate debtor, it has to be shown that the corporate debtor owes a financial debt to such person. Understood this way, it becomes clear that a third party to whom the corporate debtor does not owe a financial debt cannot become its financial creditor for the purpose of Part II of the Code."

The Supreme Court further observed that (page 746) :

"A conjoint reading of the statutory provisions with the enunciation of this court in *Swiss Ribbons*[1], leaves nothing to doubt that in the scheme of the IBC, what is intended by the expression 'financial creditor' is a person who has direct engagement in the functioning of the corporate debtor ; who is involved right from the beginning while assessing the viability of the corporate debtor ; who would engage in restructuring of the loan as well as in reorganisation of the corporate debtor's business when there is financial stress. In other words, the financial creditor, by its own direct involvement in a functional existence of corporate debtor, acquires unique position, who could be entrusted with the task of ensuring the sustenance and growth of the corporate debtor, akin to that of a guardian. In the context of insolvency resolution process, this class of stakeholders namely, financial creditors, is entrusted by the Legislature with such a role that it would look forward to ensure that the corporate debtor is rejuvenated and gets back to its wheels with reasonable capacity of repaying its debts and to attend on its other obligations. Protection of the rights of all other stakeholders, including other creditors, would obviously be concomitant of such resurgence of the corporate debtor.

Keeping the objectives of the Code in view, the position and role of a person having only security interest over the assets of the corporate debtor could easily be contrasted with the role of a financial creditor because the former shall have only the interest of realising the value of its security (there being no other stakes involved and least any stake in the corporate debtor's growth or equitable liquidation) while the latter would, apart from looking at safeguards of its own interests, would also and simultaneously be interested in rejuvenation, revival and growth of the corporate debtor. Thus understood, it is clear that if the former, i. e., a person having only security interest over the assets of the corporate debtor is also included as a financial creditor and

1. *Swiss Ribbons P. Ltd.* v. *Union of India* [2019] 213 Comp Cas 198 (SC).

thereby allowed to have its say in the processes contemplated by Part II of the Code, the growth and revival of the corporate debtor may be the casualty. Such result would defeat the very objective and purpose of the Code, particularly of the provisions aimed at corporate insolvency resolution."

The Supreme Court held that a person having only security interest over the assets of corporate debtor (like the instant third party securities), even if falling within the description of "secured creditor" by virtue of collateral security extended by the corporate debtor, would nevertheless stand outside the sect of "financial creditors" as per the definitions contained in clauses (7) and (8) of section 5 of the Code. Differently put, if a corporate debtor has given its property in mortgage to secure the debts of a third party, it may lead to a mortgage debt and, therefore, it may fall within the definition of "debt" under section 3(10) of the Code. However, it would remain a debt alone and cannot partake the character of a "financial debt" within the meaning of section 5(8) of the Code.

Assignee as financial creditor

Acknowledgment of assignment : The bank which had granted financial facilities to the corporate debtor assigned together with the underlying securities, save and except a stand by letter of credit in favour of the petitioner through an assignment deed. A petition filed by the assignee in respect of a financial debt was questioned by the corporate debtor, inter alia, on the ground that the assignment contravened the RBI Guidelines and the Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002. Section 5(3) of the 2002 Act, provides for assignment of the loan with all underlying security and guarantees, etc. Admitting the petition, the Adjudicating Authority was inter alia of the view that there was no condition stipulated in section 5 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, that an asset reconstruction company had to acquire only non-performing assets of banks or financial institutions. It held that the agreement to assign was in consideration of the assignee having deposited the purchase consideration in the escrow account and therefore, the assignment was for valuable consideration received. And also that the bank had represented and warranted to the petitioner that as on the date of the deed and with reference to the facts and circumstances then existing, the loans were non-performing assets and had been duly and validly classified as such, in accordance with the guidelines issued by the Reserve Bank of India in this regard and all applicable laws. Therefore, it was held that the petitioner was a financial creditor and it could initiate the

proceedings under section 7 of the Code. The executive director and shareholder of the corporate debtor went on an appeal contending that the claim was based on an illegal assignment of a loan. The Appellate Tribunal affirming the admission order held that the assignment could not be challenged in the petition under section 7 and that too by a party who had knowledge of the assignment deed as far back as in the year 2012, as noted by the Debts Recovery Tribunal. It took note of the letter written by the corporate debtor on March 19, 2018 wherein the corporate debtor had agreed to the assignment (*Phoenix ARC P. Ltd.* v. *GPI Textiles Ltd.* [2020] 221 Comp Cas 99 (NCLT) affirmed in *Lalan Kumar Singh* v. *Phoenix ARC P. Ltd.* [2020] 221 Comp Cas 122 (NCLAT)).

Limitation

Acknowledgment in balance-sheet : Petitions under sections 7 and 9 of the Code have been filed within 3 years from the date of default. Section 18 of the Limitation Act, 1963 provided for extension of this period if the debt is acknowledgement within the prescribed limitation period. A petition under section 7 of the Code was admitted by the Adjudicating Authority in *UV Asset Reconstruction Co. Ltd.* v. *Kalpataru Cold Storage P. Ltd.* [2020] 221 Comp Cas 131 (NCLT). The Authority gave a finding that in the year 2016, the corporate debtor had acknowledged the debt in its balance-sheet and this acknowledgment of debt brought the claim of the financial creditor within the period of limitation. Therefore, it was of the view that the petition was filed well within the period of limitation and that the debt was not time-barred. The Appellate Tribunal in *Gautam Sinha* v. *UV Asset Reconstruction Co. Ltd.* [2020] 221 Comp Cas 139 (NCLAT) disagreed with this finding of the Adjudicating Authority. On facts, the Tribunal noticed that (i) the auditor had recorded that in its own opinion and according to the information and explanations given, the company had not defaulted in the repayment of loan or borrowings to the financial institution, (ii) that a statement of fact was also recorded that the bank had declared the corporate debtor as a non-performing asset and the proceedings were pending before the Debts Recovery Tribunal and, (iii) that the company claimed to the auditors that the company had not defaulted in the repayment of loans or borrowings. The Appellate Tribunal was of the view that this could not be read as acknowledgment. The fact that the directors' report which was to be read along with the balance-sheet had no acknowledgment of debt was also pointed. It was also held that the statement recorded by the auditor with regard to the pending litigation could not be read as an acknowledgment by the company under section 18 of the 1963 Act. Since the contents in the balance-sheet did not show that the corporate debtor

had acknowledged the liability to pay the alleged outstanding debt, the petition was held as time-barred for the purpose of filing of the petition under section 7 of the Code. A five Member Bench of the Appellate Tribunal (with one Member dissenting) in *V. Padmakumar* v. *Stressed Assets Stabilization Fund (SASF)* [2020] 221 Comp Cas 153 (NCLAT) has held that as the filing of the balance-sheet and annual return was mandatory under section 92(4) of the Companies Act, 2013, failing of which penal action under section 92(5) and (6) of the 2013 Act was attracted, the balance-sheet or annual return of the corporate debtor could not be treated to be an acknowledgment under section 18 of the 1963 Act. If the balance-sheet or annual return of the corporate debtor were taken to amount to acknowledgment under section 18 of the 1963 Act no limitation would be applicable because every year, it was mandatory for the corporate debtor to file balance-sheet and annual return. However, the dissenting Member was of the view that the balance-sheets could be looked into to see if there was an acknowledgment of debt and that the amount borrowed was shown in the balance-sheet, it might amount to acknowledgment. Therefore, he was of the view that annual returns or audited balance-sheets, one-time settlement proposals, proposals to restructure loans, by whatever names called, could not be simply ignored as debarred from consideration and in every given matter, it would be a question of applying the facts to the law and vice versa, to see whether or not the specific contents spell out an acknowledgment under the 1963 Act. The order of the Adjudicating Authority in *Stressed Assets Stabilization Fund (SASF)* v. *Uthara Fashion Knitwear Ltd.* [2020] 221 Comp Cas 148 (NCLT) wherein the question of limitation was decided based on the balance sheet of the corporate debtor was reversed.

Date of default **:** The Appellate Tribunal also considered the decisions of the Supreme Court in *Gaurav Hargovindbhai Dave* v. *Asset Reconstruction Co. (India) Ltd.* [2019] 8 Comp Cas-OL 250 (SC), *Vashdeo R. Bhojwani* v. *Abhyudaya Co-operative Bank Ltd.* [2019] 8 Comp Cas-OL 551 (SC) and *V. Hotels Ltd.* v. *Asset Reconstruction Co. (India) Ltd.* [2020] 218 Comp Cas 198 (NCLAT) to observe that "for the purpose of computing the period of limitation of application under section 7, the date of default is 'NPA' and hence a crucial date".

Effect of filing suit or decree **:** The Appellate Tribunal relying on the decision in *Jignesh Shah* v. *Union of India* [2019] 217 Comp Cas 139 (SC) to observe that mere filing of a suit for recovery or a decree passed by a court cannot shift forward the date of default. A suit for recovery of money can be filed only when there is a default of dues. Even if the decree is

passed, the date of default does not shift forward to the date of decree or date of payment for execution. As a decree can be executed within specified period, i. e., 12 years. If it is executable within the period of limitation, one cannot allege that there is a default of decree or payment of dues. Therefore, it held that a judgment or a decree passed by a court for recovery of money by the civil court or Debts Recovery Tribunal could not shift forward the date of default for the purpose of computing the period for filing an application under section 7 of the Code. (See pages 165 and 166 of 221 Comp Cas).