Between the lines...

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I. Supreme Court upholds the constitutional validity of the Insolvency and Bankruptcy Code

The Supreme Court of India in the case of ***Swiss Ribbons Private Limited and Another v. Union of India and Others*** *(decided on January 25, 2019)* upheld the constitutional validity of the Insolvency and Bankruptcy Code, 2016 (**"Code"**).

Facts and issue

Several writ petitions and special leave petitions were filed before the Supreme Court for challenging the constitutional validity of various provisions of the Code. Since the judgement dealt only with the question of law relating to the constitutional validity of the Code, it did not provide for the individual facts of any case.

Arguments

Swiss Ribbons Private Limited and other petitioners (**"Appellants"**) argued that the Code is invalid for the following reasons:

(a) The appointment of members of the National Company Law Tribunal (**"NCLT"**) and National Company Law Appellate Tribunal (**"NCLAT"**) is contrary to the precedents of the Supreme Court as two judicial members of the selection committee for the appointment of members, get outweighed by three bureaucrats. Further, the administrative support for all tribunals should be from the Ministry of Law and Justice whereas NCLT and NCLAT functions under the Ministry of Corporate Affairs (**"MCA"**).

(b) The NCLAT, as an appellate court, having a seat only at New Delhi, would render the remedy inefficacious inasmuch as persons would have to travel from Tamil Nadu, Calcutta and Bombay to New Delhi, whereas earlier, they could have approached the High Courts in their respective States.

(c) Classification between financial creditors and operational creditors is violative of Article 14 of the Indian Constitution as it is not only discriminatory, but also manifestly arbitrary, as under Sections 8 and 9 of the Code, an operational debtor is not only given notice of default, but is entitled to dispute the genuineness of the claim. In the case of a financial debtor, on the other hand, no notice is given and the financial debtor is not entitled to dispute the claim of the financial creditor. Further, unless operational creditors amount to 10% of the aggregate of the amount of debt owed, they have no voice in the committee of creditors. Under Sections 21 and 24 of the Code, operational creditors do not have even a single vote in the committee of creditors which has very important functions to perform in the resolution process of corporate debtor.

(d) Section 12A of the Code provides for the settlement process by requiring the approval of at least 90% of the voting share of the committee of creditors. Hence, unbridled and uncanalized power is given to the committee of creditors to reject legitimate settlements entered into between the creditors and the corporate debtors.

(e) Grant of adjudicatory power to resolution professional which is a non-judicial authority, under the Code and the regulations made thereunder (**"Regulations"**), is violative of basic aspects of dispensation of justice and access to justice.

(f) Section 29A of the Code is invalid as the vested rights of erstwhile promoters to participate in the recovery process of a corporate debtor have been impaired by retrospective application of Section 29A. Under Section 29A(c), a blanket ban on participation of all promoters of corporate debtors, without any mechanism to weed out those who are unscrupulous and have brought the company to the ground, as against persons who are efficient managers, but who have not been able to pay their debts due to various other reasons, is arbitrary and does not treat unequals as equals. Under Section 29A(j), relatives of the erstwhile promoters are also debarred, despite the fact that they may have no business connection with the erstwhile promoters who have been rendered ineligible by Section 29A.

(g) Section 53 of the Code is invalid as in the event of liquidation, operational creditors will never get anything as they rank below all other creditors, including other unsecured creditors who happen to be financial creditors.

The Attorney General for India and the Solicitor General for India appearing for the Union of India and the Senior Advocate, appearing for the Reserve Bank of India have countered the arguments of the Appellants and relying on the precedents of the courts and committee reports, submitted that the provisions of the Code are constitutionally valid.

Observations of the Supreme Court

For the respective contentions of the Appellants, observation of the Supreme Court are as follows:

(a) <u>Appointment of members of the NCLT and the NCLAT:</u> As per the Companies (Amendment) Act, 2017, two judicial members are to be appointed and two executive members are to be appointed in the NCLT and the NCLAT. Further, as per the affidavit filed by MCA, earlier appointments were also as per the precedents of the

Supreme Court and hence the same is valid. With regard to the NCLT and the NCLAT functioning under MCA, the Supreme Court, relying on its earlier judgement in case of ***Union of India v. R. Gandhi, President, Madras Bar Association [(2010) 11 SCC 1],*** which provided for administrative support for all Tribunals to be from the Ministry of Law and Justice, directed the Union of India to follow the said judgement both in letter and spirit.

(b) NCLAT bench only at Delhi: Relying on its earlier judgement in case of ***Madras Bar Association v. Union of India [(2014) 10 SCC 1],*** which provided that permanent benches needed to be established at the seat of every jurisdictional High Court and if that was not possible, at least a circuit bench was required to be established at every place where an aggrieved party could avail of his remedy, the Supreme Court directed the Union of India to set up Circuit Benches of the NCLAT within a period of 6 months from the date of the judgement.

(c) Classification between financial creditor and operational creditor: The Supreme Court after having a detailed analysis of the provisions of the Code, the Bankruptcy Law Reforms Committee report, the Insolvency Law Committee report, 2018 and the Regulations, held that classification is not violative of Article 14 of Indian Constitution as *"financial creditors are, from the very beginning, involved with assessing the viability of the corporate debtor. They can, and therefore do, engage in restructuring of the loan as well as reorganization of the corporate debtor's business when there is financial stress, which are things operational creditors do not and cannot do. Thus, preserving the corporate debtor as a going concern, while ensuring maximum recovery for all creditors being the objective of the Code, financial creditors are clearly different from operational creditors and therefore, there is obviously an intelligible differentia between the two which has a direct relation to the objects sought to be achieved by the Code."*

With regard to no notice given to the financial debtor, the Supreme Court observed that the information in respect of debts incurred by financial debtors is easily available through information utilities. Further, under Section 7(5) of the Code, the corporate debtor is served with a copy of the application filed with the adjudicating authority and has the opportunity to file a reply before the said authority. In case the information provided by the financial creditor is false, penal provisions can be invoked.

With regard to financial debtor not being entitled to dispute the claim of the financial creditor, the Supreme Court observed that the trigger for a financial creditor's application is non-payment of dues when they arise under the loan agreements. The legislative policy has now moved away from the concept of "inability to pay debts" to "determination of default". A "claim" gives rise to a "debt" only when it becomes "due", whereas, a "default" occurs only when a "debt" becomes "due and payable" and is not paid by the debtor. It is for this reason that a financial creditor has to prove "default" as opposed to an operational creditor who merely "claims" a right to payment of a liability or obligation in respect of a debt which may be due.

With regard to voting rights of the operational creditors, the Supreme Court observed that since the financial creditors are in the business of money lending, banks and financial institutions are best equipped to assess

viability and feasibility of the business of the corporate debtor. On the other hand, operational creditors, who provide goods and services, are involved only in recovering amounts that are paid for such goods and services, and are typically unable to assess viability and feasibility of business. The NCLAT while looking into viability and feasibility of resolution plans, approved by the committee of creditors, always check whether operational creditors are given roughly the same treatment as financial creditors, and if they are not, such plans are either rejected or modified so that the operational creditors' rights are safeguarded. Further, a resolution plan cannot pass muster under Section 30(2)(b) read with Section 31 of the Code, unless a minimum payment is made to operational creditors, being not less than liquidation value. Amendment to Regulation 38 of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (**"CIRP Regulations"**) further strengthens the rights of operational creditors by statutorily incorporating the principle of fair and equitable dealing of operational creditors' rights, together with priority in payment over financial creditors.

(d) Validity of Section 12A of the Code: The Supreme relied on its judgement in case of ***Brilliant Alloys Private Limited v. Mr. S. Rajagopal and Others*** *(decided on December 14, 2018),* which stated that Regulation 30A(1) of the CIRP Regulations is not mandatory but is directory in nature and on the facts of the case, an application for withdrawal may be allowed in exceptional cases even after issue of invitation for expression of interest under Regulation 36A. The Supreme Court observed that once the Code gets triggered by admission of a creditor's petition under Sections 7 to 9 of the Code, proceeding that is before the adjudicating authority, being a collective proceeding, is a proceeding in rem. Being a proceeding in rem, it is necessary that the body which is to oversee the resolution process must be consulted before any individual corporate debtor is allowed to settle its claim. This high threshold of approval of 90% has been explained in the Insolvency Law Committee report, 2018 that all financial creditors have to put their heads together to allow such withdrawal as, ordinarily, an omnibus settlement involving all creditors ought, ideally, to be entered into. In any case, the figure of 90% of voting power is in the domain of the legislative policy. Further, the committee of creditors do not have the last word on the subject and same can be set aside by the NCLT and thereafter by the NCLAT under Section 60 of the Code.

(e) Powers of Resolution Professional: Examining Section 18 of the Code read with Regulations 10, 12, 13 and 14 of the CIRP Regulations, the Supreme Court observed that the resolution professional is given administrative as opposed to quasi-judicial powers. Further, unlike the liquidator, the resolution professional cannot act in a number of matters without the approval of the committee of creditors under Section 28 of the Code, which can, by a two-thirds majority, replace one resolution professional with another, in case they are unhappy with his performance. Thus, the resolution professional is really a facilitator of the resolution process, whose administrative functions are overseen by the committee of creditors and by the adjudicating authority.

(f) Validity of Section 29A of the Code: It is settled law that a statute is not retrospective merely because it affects existing rights; nor is it retrospective merely because a part of the requisites for its action is drawn from a time antecedent to its passing. Relying on its earlier judgement in case of ***ArcelorMittal India Private Limited v. Satish Kumar Gupta and Others*** *(decided on October 4, 2018),* the Supreme Court observed that since a resolution

applicant who applies under Section 29A(c) has no vested right to apply for being considered as a resolution applicant, their vested rights were not affected with retrospective application of Section 29A of the Code.

While examining Section 29A(c) of the Code, the Supreme Court observed that where an erstwhile manager is not guilty of malfeasance or of acting contrary to the interests of the corporate debtor, there is no reason why he should not be permitted to take part in the resolution process. There is no vested right in an erstwhile promoter of a corporate debtor to bid for the immovable and movable property of the corporate debtor in liquidation. The legislative purpose which permeates Section 29A continues to permeate the section when it applies not merely to resolution applicants, but to liquidation also.

With regard to barring the relatives of the erstwhile promoters under Section 29A(j) of the Code, "persons who act jointly or in concert with others" are "connected" with the business activity of the resolution applicant. Similarly, all the categories of persons mentioned in Section 5(24A) show that such persons must be "connected" with the resolution applicant within the meaning of Section 29A(j). This being the case, the said categories of persons who are collectively mentioned under the caption "relative" obviously need to have a connection with the business activity of the resolution applicant. In the absence of showing that such person is "connected" with the business of the activity of the resolution applicant, such person cannot possibly be disqualified under Section 29A(j). Further, "connected person" in Explanation I, clause (ii) to Section 29A(j) of the Code, does not refer to a person who is indeterminate, but to a person who is in the saddle of the business of the corporate debtor either at an anterior point of time or even during implementation of the resolution plan.

(g) Validity of Section 53 of the Code: The reason for differentiating between financial debts, which are secured, and operational debts, which are unsecured, is in the relative importance of the two types of debts when it comes to the object sought to be achieved by the Code. Repayment of financial debts infuses capital into the economy inasmuch as banks and financial institutions are able, with the money that has been paid back, to further lend such money to other entrepreneurs for their businesses. This rationale creates an intelligible differentia between financial debts and operational debts which are unsecured, which is directly related to the object sought to be achieved by the Code. In any case, workmen's dues, which are also unsecured debts, have traditionally been placed above most other debts. Thus, it can be seen that unsecured debts are of various kinds, and so long as there is some legitimate interest sought to be protected, having relation to the object sought to be achieved by the statute in question, Article 14 of the Indian Constitution does not get infracted.

Decision of the Supreme Court

The Supreme Court upheld the constitutional validity of the Code.

VA View

While upholding the constitutional validity of the Code, the Supreme Court conducted an overall analysis of its provisions and looked into the economic aspects behind it as well.

While noting that the bad debt problem was steadily growing, and a need for overhaul was required, burning questions, like the raison d'être of the different treatment of operational and financial creditors have finally been put to rest by the Supreme Court. The Supreme Court has reiterated the validity of Section 12A of the Code ensuring that the central idea of maximization of value of the assets of the corporate debtor does not get lost in procedural hurdles. The court also upheld the validity Section 29A of the Code to ensure that persons responsible for driving a company into insolvency do not regain control of the company without first paying off their debts. As is evident from the ruling regarding setting up of NCLAT circuit benches within a period of 6 months from the date of the judgement, the Supreme Court also stepped in to ensure that the infrastructure required for the smooth functioning of the Code is present.

Further, in stating that the Code is an economic legislation and that as far as legislation on economic matters is concerned, leeway should be given to the legislature as no economic law can be foolproof on its inception. The Supreme Court has laid down the tone and tenor for interpretation of future economic legislations by holding that *"there may be crudities and inequities in complicated experimental economic legislation but on that account alone it cannot be struck down as invalid".*

This judgement is a ringing endorsement of the Code, and the statistics furnished to the Supreme Court only strengthen that assertion. Indeed, as mentioned in the judgement, the 'defaulter's paradise' is lost and the economy's rightful position has been regained in its place.

II. Supreme Court: Mere delay in passing the award by itself cannot be a ground to appoint another arbitrator

The Supreme Court of India in the case of ***Rajasthan Small Industries Corporation Limited v. M/s Ganesh Containers Movers Syndicate*** *(dated January 23, 2019)* held that mere neglect of an arbitrator to act or delay in passing the award by itself cannot be a ground to appoint another arbitrator in deviation from the terms agreed to by the parties.

Facts

Rajasthan Small Industries Corporation Limited (**"Appellant"**) and Ganesh Containers Movers Syndicate (**"Respondent"**) had executed a commercial agreement for *"Handling and Road transportation of ISO containers and Cargo between Inland container Depots"* on January 28, 2000, pursuant to the Respondent winning a tender bid. Certain contractual disputes relating to payments and penalties arose between the parties.

The terms of the contract provided for arbitration by the managing director himself or his or her nominee for the sole arbitration. The Respondent requested for appointment of the arbitrator in terms of the contract and therefore, one IC Shrivastava (Retd. IAS) was initially appointed as the sole arbitrator. Since the progress of the sole arbitrator was not satisfactory in disposing of the matter, the said sole arbitrator was removed on March 26, 2009 and in his place, the chairman-cum-managing director of the Appellant was appointed to act as the sole arbitrator with the consent of both the parties. However, the arbitration proceedings could not be concluded and there were repeated adjournments of the proceedings.

On March 16, 2010, the Respondent raised its doubts regarding impartiality of the newly appointed sole arbitrator. On February 07, 2013, the Respondent sent a legal notice to the Appellant stating that even after so many requests, the sole arbitrator has not passed the award and called upon the Appellant to pay the amount of INR 3,90,81,602 which was said to have been settled along with the statutory interest, within one month. The Appellant sent a reply dated March 19, 2013 stating that since the chairman-cum-managing director has been transferred, the award could not be passed and there is no question of payment to the Respondent.

Subsequently, on May 13, 2015, the Respondent filed an application under Section 11(6) and Section 15 of the Arbitration and Conciliation Act, 1996 (**"Arbitration Act"**) before the Rajasthan High Court seeking appointment of an independent arbitrator for the adjudication of dispute between the parties in respect of agreement dated January 28, 2000. Meanwhile, the sole arbitrator passed an ex-parte award on January 21, 2016.

The Rajasthan High Court allowed the arbitration application, thereby appointing another sole arbitrator. The Rajasthan High Court held that the Respondent had to approach the court due to prolongation of the matter, owing to which the arbitration proceedings were frustrated. Further the award was passed *ex-parte* to the prejudice of the Respondent. The Appellant approached the Supreme Court in an appeal.

Issues

1. Whether the Respondent was right in filing arbitration petition approaching the High Court under Sections 11 and 15 of the Arbitration Act for appointment of a substitute arbitrator?

2. Whether the High Court was right in deviating from the terms of the agreement between the parties and appointing an independent arbitrator?

3. Whether by virtue of Section 12 of the Arbitration and Conciliation (Amendment) Act, 2015, the chairman-cum-managing director was ineligible to act as the arbitrator?

4. Whether the High Court was right in terminating the mandate of the arbitrator whom the parties have agreed and consequent appointment of a substitute arbitrator on the ground that there was delay in passing the award?

Arguments

The Appellant argued the following key points:

1. The High Court erred in not considering the fact that the Respondent had no right to move an application under Sections 11 and 15 of the Arbitration Act, in the light of the agreement between the parties and the competence of the arbitral tribunal to adjudicate the dispute between the parties.

2. The Respondent could have only challenged the order by an appeal under Section 34 of the Arbitration Act.

3. The arbitrator could not make progress since the Respondent was either not present, or continually taking adjournments, and when the arbitrator was proceeding with the matter in right earnest, the Respondent could not have approached the High Court seeking appointment of an independent arbitrator.

The Respondent argued the following key points:

1. If the arbitrator is an employee/ advisor or has any past or present business relation or being the manager/ director then he cannot be appointed as an arbitrator and not qualified to decide the dispute and therefore, the High Court has rightly appointed the fresh independent arbitrator.

2. When there is failure on the part of the arbitral tribunal to act and unable to perform its functions, it is open to a party to the arbitration proceedings to approach the court for termination of the mandate of the arbitrator and seek appointment of the substitute arbitrator. Since for a long period of about ten years, no award had been passed and that the arbitrators were kept on changing for one reason or other; the Respondent was justified in approaching the High Court for substitution or appointment of fresh arbitrator.

Observations of the Supreme Court

The Supreme Court observed that according to the order dated of the arbitral tribunal October 21, 2010, the Respondent submitted that *"they do not want to prolong the matter further and they have full faith in the present sole arbitrator and that they would like the sole arbitrator to decide the case and pass an award on the basis of material available on record at the earliest."* A major reason for the delay in the proceedings was the loss of case papers requiring reconstruction of records. The Respondent voluntarily participated and acquiesced in the proceedings before the arbitral tribunal and also expressed faith in the sole arbitrator. The parties had consciously agreed that the disputes or differences shall be referred to the managing director himself or his nominee for sole arbitration.

The Respondent at a belated stage could not be allowed to turn around and seek for appointment of an independent arbitrator. The Respondent was unable to produce anything on record to show that the arbitrator had not acted independently. The arbitration proceedings started way back in 2009 long before the Arbitration and Conciliation (Amendment) Act, 2015 came into force and therefore, the same was not applicable to this case. The Respondent had neither filed a request case for passing of the award at an early date nor filed the petition under Section 14 of the Arbitration Act for termination of the mandate of the arbitrator.

In view of the above, the Supreme Court observed that the High Court was not right in appointing another arbitrator, without taking into consideration the terms of the agreement of the parties. Even though the proceedings of the arbitral tribunal were pending since 2009 to 2015, after the Respondent approached the High Court in May, 2015, the arbitrator made haste in passing the order. The phrase "complete justice" in Article 142(1) of the Constitution of India is wide enough to meet myriad situations.

Decision of the Supreme Court

The Supreme Court rejected the contentions of the Respondent and held that the application under Sections 11 and 15 of the Arbitration Act were not maintainable in law, and thereby set aside the order of the Rajasthan High Court. The Supreme Court exercised its wide powers under Article 142 of the Constitution of India and also set aside the award passed by the sole arbitrator, and appointed the current managing director of the Appellant as the arbitrator, to restart the arbitration proceedings, and given the parties sufficient chance to present their case, within a time period of four months.

VA View

The Supreme Court has taken a holistic approach in addressing the problems of this case. Not only was the court able to look through the dilatory tactics of the Respondent, but at the same time was able to pinpoint the need to do complete justice, by setting aside the award passed in haste. The Supreme Court has been able to strike an equilibrium by interpreting the law perfectly in line with its precedents, while harmonizing the peculiar facts of the case. The Respondent was not allowed to rely on the ground of delay by the arbitrator as ground to set aside an award, that too by the invocation of Section 11 of the Arbitration Act which deals with appointment of an arbitrator by the court. Further, the Respondent failed to file a petition under Section 14 of the Arbitration Act for the termination of the arbitrator's mandate, which would have been the correct remedy under the law.

In the instant case, the Supreme Court did not favor any one party and did complete justice by setting aside the award by the arbitrator, which was clearly bad in law. The court has given the arbitration agreement primary importance, disabled a party from misusing Sections 11 *(appointment of arbitrators),* 12 *(grounds for challenge the mandate of an arbitrator)* and 15 *(termination of mandate and substitution of arbitrator)* of the Arbitration Act, and identified the proper remedy being an application under Section 34 of the Arbitration Act.

III. Supreme Court: CIRP under Insolvency and Bankruptcy Code can continue independent of winding-up petition in the High Court

The Supreme Court of India in the case of ***Forech India Limited v. Edelweiss Asset Reconstruction Company Limited*** *(decided on January 22, 2019)* held that the corporate insolvency resolution process (**"CIRP"**) initiated under the Insolvency and Bankruptcy Code, 2016 (**"Code"**) can continue independent of a winding-up petition in a High Court.

Facts

Forech India Limited (**"Appellant/ Corporate Debtor"**) filed a reference with Board for Industrial and Financial Reconstruction (**"BIFR"**) under the Sick Industrial Companies Act, 1985 (**"SICA"**) on July 14, 2015 which abated as per the Sick Industrial Companies Repeal Act, 2003. An operational creditor filed an application under Section 9 of the Code, against the Appellant which was allowed to be withdrawn so that the aforesaid operational creditor could approach the High Court in a winding up petition which would then be heard along with the application of the other creditor which was pending disposal.

Meanwhile, Edelweiss Asset Reconstruction Company Limited (**"Respondent"**) moved an application under Section 7 of the Code against the Corporate Debtor before the National Company Law Tribunal (**"NCLT"**) which was admitted. The Appellant preferred an appeal before the National Company Law Appellate Tribunal (**"NCLAT"**) challenging order of the NCLT, *inter alia,* stating the position of pendency of the winding up petition wherein notice has already been issued. The NCLAT dismissed the appeal by stating that since there was no winding up order by the High Court, the financial creditor's petition would be maintainable. Therefore, the Appellant approached the Supreme Court, challenging the order of the NCLAT and the following issue came up for determination:

Issue

Whether an application for corporate insolvency resolution process under the Code can be made during the pendency of winding up proceedings under the Companies Act, 1956?

Arguments

The Appellant argued that notice was served on the Corporate Debtor in terms of Rule 26 of the Companies (Court) Rules, 1959. The Appellant further contended that as per Section 434 of the Companies Act, 2013 as amended by the Code, read with Rule 5 of the Companies (Transfer of Proceedings) Rules, 2016, winding up petitions will be transferred to NCLT only if notice of petition has not been served on the Respondent as per Rule 26 of the Companies (Court) Rules, 1959. Section 434(c) of the Companies Act, 2013, as applicable in the instant matter, is reproduced below:

"Transfer of Certain Pending Proceedings.

434. (1) On such date as may be notified by the Central Government in this behalf,--

(c) all proceedings under the Companies Act, 1956, including proceedings relating to arbitration, compromise, arrangements and reconstruction and winding up of companies, pending immediately before such date before any District Court or High Court, shall stand transferred to the Tribunal and the Tribunal may proceed to deal with such proceedings from the stage before their transfer:

Provided that only such proceedings relating to the winding up of companies shall be transferred to the Tribunal that are at a stage as may be prescribed by the Central Government.

Provided further that any party or parties to any proceedings relating to the winding up of companies pending before any Court immediately before the commencement of the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018, may file an application for transfer of such proceedings and the Court may by order transfer such proceedings to the Tribunal and the proceedings so transferred shall be dealt with by the Tribunal as an application for initiation of corporate insolvency resolution process under the Insolvency and Bankruptcy Code, 2016 (31 of 2016).”

(Emphasis supplied)

Rule 5 of the Companies (Transfer of Proceedings Rules) 2016 is reproduced below:

“(1) All petitions relating to winding up of a company under clause (e) of section 433 of the Act on the ground of inability to pay its debts pending before a High Court, and, where the petition has not been served on the respondent under rule 26 of the Companies (Court) Rules, 1959 shall be transferred to the Bench of the Tribunal established under sub-section (4) of section 419 of the Companies Act, 2013 exercising territorial jurisdiction to be dealt with in accordance with Part II of the Code:

Provided that the petitioner shall submit all information, other than information forming part of the records transferred in accordance with rule 7, required for admission of the petition under sections 7, 8 or 9 of the Code, as the case may be, including details of the proposed insolvency professional to the Tribunal upto 15th day of July, 2017, failing which the petition shall stand abated:

Provided further that any party or parties to the petitions shall, after the 15th day of July, 2017, be eligible to file fresh applications under sections 7 or 8 or 9 of the Code, as the case may be, in accordance with the provisions of the Code:

Provided also that where a petition relating to winding up of a company is not transferred to the Tribunal under this rule and remains in the High Court and where there is another petition under clause (e) of section 433 of the Act for winding up against the same company pending as on 15th December, 2016, such other petition shall not be transferred to the Tribunal, even if the petition has not been served on the respondent."

(Emphasis supplied)

Relying on this, the Appellant contended that the petition could have been retained in the High Court, as notice under Rule 26 of the Companies (Court) Rules, 1959 was already served on the Respondent.

The Respondent, on the other hand stated that the whole objective of the Code would get frustrated if parallel proceedings were allowed before different fora. The Respondent referred to the *non-obstante* clause in Section 238 of the Code, and argued that the provisions of the Code shall have overriding effect, notwithstanding anything inconsistent therewith contained in any other law for the time being in force.

Observations of the Supreme Court

The Supreme Court stated that it is clear that Rule 26 and Rule 27 of the Companies (Court) Rules, 1959,refer to a pre-admission scenario. Therefore, the winding up petition of the Appellant filed under Section 433(e) of the Companies Act, 1956, would not be transferred to the NCLT and shall be heard under the provisions of the Companies Act, 1956 when notice under Rule 26 of the Companies (Court) Rules, 1959 has been served upon the Respondent.

The Supreme Court declined to strike down the order passed by the NCLAT as it held that the financial creditor's application which has been admitted by the NCLT is clearly an independent proceeding which must be decided in accordance with the provisions of the Code and is not contained with the winding up petition pending before the High Court.

Decision of the Supreme Court

The order of the NCLAT was upheld and parallel proceedings in the NCLT and the High Court were allowed.

VA View

This judgement will clarify the law involved, specifically with regards to the transfer of proceedings from the High Court to the NCLT, and generally with regards to the Code *vis-a-vis* the Companies Act. The decision of the Supreme Court in this case clarifies an important part of the legal framework put into place since the introduction of the Code and on the interoperability of the Code with legislations already in place. The Supreme Court has taken a middle path while answering the larger question of whether an application for corporate insolvency resolution process under the Code can be made during the pendency of winding up proceedings, drawing a proverbial line in the sand which states that a winding up petition filed under Section 433(e) of the Companies Act, 1956 can be transferred if notice under Rule 26 of the Companies (Court) Rules, 1959 has not been served.

IV. NCLAT: Refusal to reconcile statements results in a continuous cause of action which cannot be barred by limitation in an insolvency application

In ***Mr. Engin Nasiroglu v. RVR Projects Private Limited and Another*** *(dated December 19, 2018),* the National Company Law Appellate Tribunal (**"NCLAT"**) has held that failure to reconcile the invoices drawn towards Fernas Insaat A S (**"Corporate Debtor"**) has resulted in a continuous cause of action. Therefore, an application for initiating insolvency resolution process against the Corporate Debtor cannot be considered time barred.

Facts

The Corporate Debtor is in the business of construction and had undertaken several high value projects. For execution of certain works with respect to the project, the Corporate Debtor engaged the services of RVR Projects Private Limited (**"Operational Creditor"**) in 2011. The Operational Creditor started to execute the works and raised invoices. The Corporate Debtor released part payment of the invoices. Thereafter, the Corporate Debtor issued another work order which was foreclosed midway. The Corporate Debtor admitted a debt under both the work orders and made part payment yet again. The Operational Creditor issued a demand notice under Section 8

of the Insolvency and Bankruptcy Code, 2016 (**"Code"**) and after it received no reply, it made an application before the National Company Law Tribunal, Delhi (**"NCLT"**) under Section 9 of the Code. This application was admitted by the NCLT. An appeal was filed by the Corporate Debtor in the NCLAT challenging the admission of the application stating that it was time barred and hence it should have been rejected.

Issue

Whether the NCLT ought to have admitted the insolvency application as it was time barred?

Relevant provision

Section 18(1) of the Limitation Act, 1963 (**"Limitation Act"**):

"Where, before the expiration of the prescribed period for a suit or application in respect of any property or right, an acknowledgment of liability in respect of such property or right has been made in writing signed by the party against whom such property or right is claimed, or by any person through whom he derives his title or liability, a fresh period of limitation shall be computed from the time when the acknowledgment was so signed."

Arguments

The Corporate Debtor argued that the Operational Creditor had admitted that the cause of action took place in August 2013 when the Corporate Debtor defaulted in payment of debt. Further, as three years have lapsed since the cause of action arose, the application should have been barred by limitation.

The Operational Creditor, referring to the communication made between the parties, argued that there was a continuous cause of action and therefore the claim could not be said to be barred by limitation.

Observations of the NCLAT

The NCLAT analysed several communications between the Corporate Debtor and the Operational Creditor to draw its conclusions. In a letter dated June 17, 2013 to the Operational Creditor, the Corporate Debtor confirmed the balance amount to be paid to the Operational Creditor. Thereafter, the Corporate Debtor issued two job completion certificates, both dated August 7, 2013, where under it again acknowledged the amounts. This was done to facilitate the billing by the Operational Creditor. On December 13, 2013, the Corporate Debtor issued another letter to the Operational Creditor stating that it was in the process of reconciliation of all bills along with supporting documents and as soon as reconciliation was complete, the true and correct status of outstanding balance would be communicated to the Operational Creditor and recommended to the management. The Corporate Debtor also mentioned that it had the right to progressively allocate work to the Operational Creditor commensurate with its capabilities. As the Corporate Debtor did not complete its reconciliation, the demand notice under the Code was issued by the Operational Creditor.

The NCLAT thereafter cited the case of ***Valliamma Champaka Pillai v. Sivathanu Pillai and Others [(1979) 4 SCC 429]*** in which it was held that for an extension of the limitation period under Section 18 of the Limitation Act, a written acknowledgement must be made involving an admission of a subsisting liability. Further, it also quoted the case of ***J.C. Budhraja v. Chairman, Orissa Mining Corporation Limited and Another [(2008) 2 SCC 444]*** under which it was decided that the admission need not be in regard to any precise amount nor by expressed words. If a

defendant writes to the plaintiff requesting him to send his claim for verification and payment, it amounts to an acknowledgment.

The NCLAT observed that in the instant case, the liability to pay has been acknowledged by the Corporate Debtor in the job completion certificate. The Corporate Debtor has never disputed the claim of the Operational Creditor. The Corporate Debtor by its letter dated December 13, 2013 stated that they were going to begin the reconciliation process and also requested the Operational Creditor to depute personnel for this purpose. The Corporate Debtor has still not completed this process and kept it open. Therefore, the NCLAT held that there was a continuous cause of action in absence of completion of reconciliation statement.

Decision of the NCLAT

The NCLAT held that the NCLT rightly admitted the insolvency application of the Operational Creditor as the claim of the Operational Creditor was not be barred by limitation.

VA View

The judgement holds that as the Corporate Debtor did not complete the reconciliation of the invoices generated by the Operational Creditor, it has resulted in a continued cause of action. This effectively means that in a circumstance when the work orders are executed and the liability of payment pursuant to the work orders is admitted; if the debtor calls for reconciliation of the statements and the same is not completed due to faults attributed to the debtor, the cause of action begins when the reconciliation statement has been finally prepared by the debtor. The NCLAT has taken an equitable stand by not allowing the limitation period to run for the period during which the debtor has refused to reconcile the accounts. It is only just and fair that the debtor should not be permitted to exhaust the limitation period by using the excuse of an unreconciled statement as this would be prejudicial to the creditor.

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Contact Details :

www.vaishlaw.com

NEW DELHI
1st, 9th & 11th Floor
Mohan Dev Bldg. 13 Tolstoy Marg
New Delhi - 110001, India
Phone: +91-11-4249 2525
Fax: +91-11-23320484
delhi@vaishlaw.com

MUMBAI
106, Peninsula Centre
Dr. S. S. Rao Road, Parel
Mumbai - 400012, India
Phone: +91-22-4213 4101
Fax: +91-22-4213 4102
mumbai@vaishlaw.com

BENGALURU
565/B, 7th Main HAL
2nd Stage, Indiranagar,
Bengaluru - 560038, India
Phone: +91-80-40903588 /89
Fax: +91-80-40903584
bangalore@vaishlaw.com