Between the lines...

VAISH ASSOCIATES ADVOCATES ESTD. 1971

NEW DELHI | MUMBAI | BENGALURU

August, 2020

Key Highlights

I. Supreme Court: Dispute as to inheritance of shares cannot be adjudicated upon in proceedings under Section 241/ 242 of Companies Act, 2013

The Supreme Court (**"SC"**) has in its judgment dated July 6, 2020 (**"Judgment"**) in the matter of ***Aruna Oswal v. Pankaj Oswal and Others [Civil Appeal No. 9340 of 2019],*** held that disputes pertaining to inheritance of shares cannot be pronounced upon in proceedings initiated under Sections 241 and 242 of the Companies Act, 2013 (**"CA 2013"**).

Facts

Brief facts of the case are that one Mr. Abhey Kumar Oswal held 53,53,960 shares in M/s. Oswal Agro Mills Limited (**"Respondent No. 2"**) and had on June 18, 2015, filed a nomination in favour of his wife, Mrs. Aruna Oswal (**"Appellant"**) under Section 72 of the CA 2013 expressly stating that *"This nomination shall supersede any prior nomination made by me/us and any testamentary document executed by me/us."* Mr. Abhey Oswal passed away intestate on March 29, 2016 and on April 16, 2016, the name of the Appellant was registered as the holder against the shares held by the late Mr. Abhey Oswal.

Thereafter, Mr. Abhey Oswal's son, Mr. Pankaj Kumar Oswal (**"Respondent No. 1"**) filed a partition suit on February 3, 2017 before the Delhi High Court (**"DHC"**), claiming entitlement to one-fourthof Mr. Abhey Oswal's estate which, *inter alia,* included shares constituting 39.88% shareholding in Respondent No. 2 and 11.11% shareholding in M/s. Oswal Greentech Limited (**"Respondent No.**

16"). Under an order dated February 8, 2017,the DHC directed the parties to maintain status quo on the shares and other immoveable property of Mr. Abhey Oswal. Consequently, the said shares continued to remain registered in the name of the Appellant.

Additionally, Respondent No. 1 also filed a Company Petition with the National Company Law Tribunal, Chandigarh (**"NCLT"**) alleging oppression and mismanagement in the affairs of the Respondent No. 2. Respondent No. 1 claimed eligibility to maintain the said petition on the ground of being the holder of 0.03% shareholding of Respondent No. 2 and claiming entitlement over and legitimate expectation over one-fourth shareholding (constituting 9.97% shareholding) of Mr. Abhey Oswal in Respondent No. 2.

Pursuant to the above, an application dated May 2018 was filed by the Appellant before the NCLT challenging the maintainability of the above stated Company Petition. However, by an order dated November 13, 2018, the NCLT dismissed the said application and held that Respondent No.1 was the legal heir to Mr. Abhey Oswal and thereby entitled to one-fourth share of his shares/ property. Aggrieved by the said order of the NCLT, the Appellant filed three appeals before the National Company Law Appellate Tribunal, Delhi (**"NCLAT"**), which appeals were also dismissed by a judgment and order of the NCLAT dated November 14, 2019. The present appeal was filed by the Appellant against the aforementioned order of the NCLAT.

Issue

Whether the question of inheritance of shares can be decided upon under a company petition for oppression and mismanagement.

Arguments

Contentions raised by the Appellant:

The Appellant, *inter alia,* contended that she was the sole nominee of the late Mr. Abhey Kumar Oswal and that in view of the provisions contained in Section 71of the CA 2013, Respondent No. 1 could not claim any interest over the shares in Respondent No. 2 registered in the name of the Appellant.

It was further contended that, upon excluding shares in the name of the Appellant, Respondent No. 1 would hold only 0.03% shareholding in Respondent No. 2 and therefore, would not constitute qualified threshold (on account of holding less than 10% shares) under Section 244 of the CA 2013, due to which the application under Sections 241 and 242 of the CA 2013 was not maintainable. Moreover, the shareholding to the extent of 0.03% in May, 2017 was purchased/ acquired by Respondent No. 1 after filing of the civil suit before the DHC.

It was also contended that since Mr. Abhey Kumar Oswal died intestate, in view of the provisions of Section 72 of the CA 2013, all the rights to the shares are now vested in the Appellant. It was further contended that although Respondent No. 1 had settled in Australia and had nothing to do with the management of Respondent No. 2, he was trying to illegally interfere in the management of Respondent No. 2.

The Appellant further contended that the NCLT and NCLAT had ignored and overlooked the rights of the deceased shareholder that had vested on the Appellant as his nominee. It was also contended that Respondent No. 1 did not claim waiver on the rigors of Section 244 of the CA 2013 and also did not file an application seeking a waiver under the proviso to Section 244 of the CA 2013.

Contentions raised by the Respondent No. 1:

Respondent No. 1 on the other hand argued that the application filed under Sections 241 and 242 of the CA 2013 was maintainable since the nomination was made only to hold the shares for the benefit of legal representatives. It was further contended that it was permissible for a legal representative to maintain the proceedings for oppression and mismanagement in the affairs of the company, though his/her name was not entered as a registered owner of the shares. Reliance was placed upon ***World Wide Agencies Private Limited and Another v. Margarat T. Desor and Others [(1990) 1 SCC 536],*** wherein the legal representatives had been given the right tomaintain the application with respect to oppression and mismanagement.

It was argued further that the waiver requirement to hold 10% shares, had been pleaded in the company petition filed by Respondent No. 1. Respondent No. 1 argued that the NCLT, as well as the NCLAT rightly held the petition to be maintainable and the civil suit's pendency could not have come in the way of maintaining the application concerning oppression and mismanagement as only civil rights have to be determined in the civil suit. Respondent No. 1 also relied upon various decisions of the SC namely: ***Smt. Sarbati Devi and Another v. Smt. Usha Devi [(1984) 1 SCC 424]; Vishin N. Khanchandani and Another v. Vidya Lachmandas Khanchandani and Another [(2000) 6 SCC 724];*** and ***Ram Chander Talwar and Another v. Devender Kumar Talwar and Others [(2010) 10 SCC 671]*** and contended that the company petition was prima facie maintainable in view of the verdicts held by SC in the said matters. Hence, no case for interference in the appeals had been made out.

Observations of the Supreme Court

The SC observed that it was apparent from a bare reading of the provisions of Section 72(1) of CA 2013 that every holder of securities has a right to nominate any person to whom his securities shall "vest" in the event of his death. In the case of joint holders also, they have a right to nominate any person to whom "all the rights in the securities shall vest" in the event of death of all joint holders. The SC noted that sub-section(3) of Section 72 of the CA 2013 contains a non-obstante clause in respect of anything contained in any other law for the time being in force or any disposition, whether testamentary or otherwise, where a nomination is validly made in the prescribed manner, it purports to confer on the person "the right to vest" the securities of the company, and therefore, all the rights in the securities shall vest in the nominee unless a nomination is varied or cancelled in the prescribed manner.

The SC further noted that prima facie shares vest in a nominee, and he becomes the absolute owner of the securities on the strength of nomination.

The SC also noted that while in ***World Wide Agencies Private Limited and Another v. Margarat T. Desor and Others [(1990) 1 SCC 536],*** the SC had held that a legal representative has a right to maintain an application regarding

oppression and mismanagement without being registered as a member against the securities of a company, but at the same time the question of nomination was not involved in the said decision, and as such, the SC was not required to decide the question of the effect of nomination. There is no doubt that in the absence of nomination, a legal representative cannot be denied the right to maintain a petition regarding oppression and mismanagement. In the instant case however, the nomination had been made, and the nominee was registered as the holder of shares. The effect of the same was required to be decided to determine the extent of shareholding of Respondent No. 1, concerning which civil suit filed earlier in point of time was pending consideration.

The SC further observed that presently, Respondent No. 1 was not holding the shares to the extent of the eligibility threshold of 10% as stipulated under Section 244 of the CA 2013 in order to maintain an application under Sections 241 and 242 of the CA 2013 since the shareholding ownership was under dispute under a civil suit for partition. The question as to the right of Respondent No. 1 was required to be adjudicated finally in the civil suit, including the effect of nomination in favour of the Appellant, and whether absolute right, title, and interest in the shares is vested in the nominee or not, was to be finally determined in the said suit. The decision in the civil suit would be binding between the parties on the question of right, title, or interest and it was the domain of a civil court to determine the right, title, and interest in an estate in a suit for partition.

The SC observed that in the case of ***Sangramsinh P. Gaekwad and Others v. Shantadevi P. Gaekwad (Dead) through LRs and Others [(2005) 11 SCC 314],*** the SC had held that the dispute as to inheritance of shares is eminently a civil dispute and cannot be said to be a dispute as regards oppression and/ or mismanagement so as to attract company court's jurisdiction under Sections 397 and 398 of the Companies Act, 1956. In view of the aforesaid decision, the SC was of the opinion that the basis of the petition in the present case was the claim by way of inheritance of one-fourth shareholding so as to constitute 10% of the holding, which right cannot be decided in proceedings under Section 241 or 242 of the CA 2013. Thus, filing of the petition under Sections 241 and 242 seeking waiver was a misconceived exercise.

Decision of the Supreme Court

In allowing the appeal, the SC took note of its judgement in ***World Wide Agencies Private Limited and Another v. Margarat T. Desor and Others [(1990) 1SCC 536]*** and the fact that the Respondent No. 1, as pleaded by him, had nothing to do with the affairs of Respondent No. 2 and he was not a registered owner and that the rights in estate/ shares, if any, of Respondent No. 1 were protected in the civil suit. Thus, the SC was satisfied that Respondent No. 1 did not represent the body of shareholders holding requisite percentage of shares in Respondent No. 2, necessary in order to maintain such a petition.

The SC observed that it was undisputed that the DHC had, in the pending civil suit, passed an order directing that status quo be maintained with respect to the shareholding and other properties of Mr. Abhey Oswal. The shares have to be held in the name of the Appellant until the suit is finally decided because of the status quo order. It would not be appropriate to entertain these parallel proceedings and give waiver as claimed under Section 244 of the CA 2013 before the civil suit's decision.

The SC was of the opinion that the proceedings before the NCLT filed under Sections 241 and 242 of the CA 2013 should not be entertained because of the pending civil dispute and considering the minuscule extent of the Respondent No. 1's holding of 0.03%.

The SC directed dropping of the proceedings filed before the NCLT regarding oppression and mismanagement under Sections 241 and 242 of the CA 2013 and also granted Respondent No. 1 the liberty to file a fresh suit, on all the questions, in case of necessity, if the civil suit was decreed in favour of Respondent No. 1 and the shareholding of Respondent No. 1 in Respondent No. 2 increased to 10%.

The SC reiterated that it had left all the questions to be decided in the civil suit pending before the DHC. The impugned orders passed by the NCLT as well as NCLAT were set aside, and the appeal was allowed.

VA View:

The SC has, in the present case, clearly outlined the principle applicable in respect of the ownership rights bestowed upon nominee holders of shares under Section 72 of CA 2013. Deviating from previously upheld precedents by the Bombay High Court (**"BHC"**), the SC passed an order in favour of the nominees. One of the most prominent cases pertaining to the instant subject matter is ***Shakti Yezdani v. Jayanand Jayant Salgaonkar*** where the BHC held that the non-obstante clause in the erstwhile Section 109A of the Companies Act, 1956 cannot supersede the general laws of succession. Further, the BHC interpreted the erstwhile Section 109A of the Companies Act, 1956, by drawing parallels with the Life Insurance Act, 1939 (**"LIC Act"**). In the instant case, the SC, dismissing this argument, differentiated between the LIC Act and Section 72 of CA 2013, emphasizing that unlike the former, the latter does not treat a nominee as merely an interim holder. The LIC Act on the other hand considers nominees to be holders of the assets that eventually become estate of the deceased upon his death, devolving upon the legal heirs of the deceased.

Furthermore, the SC has in essence reconfirmed the legislative intent behind the qualifying percentage prescribed for maintenance of an application under Sections 241 and 242 of the CA 2013, which is to discourage frivolous litigation in the guise of allegations of oppression and mismanagement by shareholders not having quantifiable and established ownership in companies.

Also, by dropping the proceedings filed before NCLT for oppression and mismanagement in the present case during the pendency of the civil suit before the DHC, the SC has once again added to the already set and established precedent of not allowing the same legal question to be put up for adjudication before different forums.

II. NCLAT: A writing to be an acknowledgement of liability must involve an admission of subsisting jural relationship between the parties and a conscious affirmation of an intention of continuing such relationship in regard to an existing liability

The National Company Law Appellate Tribunal (**"NCLAT"**) in the case of ***Mr. R.R. Gopaljee v. Indian Overseas Bank and Others*** *(decided on June 24, 2020)* upheld the order dated July 05, 2019 passed by the NCLT, special bench,

Chennai (**"Adjudicating Authority"**) under Section 7 *(initiation of corporate insolvency resolution process by financial creditor)* of the Insolvency and Bankruptcy Code (**"IBC"**) and held that a writing to be an acknowledgement of liability must involve an admission of subsisting jural relationship between the parties and a conscious affirmation of an intention of continuing such relationship in regard to an existing liability and that the said admission need not be in regard to any precise amount nor by expressed words.

Facts

Indian Overseas Bank (**"Financial Creditor"**) granted financial assistance to Malar Energy and Infrastructure Private Limited (**"Corporate Debtor"**) on various dates between June 13, 2011 and May 29, 2015. Post disbursement of the loan, the Corporate Debtor defaulted in repayment and thus, its account was declared as a Non-Performing Asset (**"NPA"**) by the Financial Creditor.

The Financial Creditor thereafter, sent a legal notice dated March 15, 2017 demanding the repayment of INR 21,86,26,661 along with interest and the Corporate Debtor in its reply dated March 27, 2017 acknowledged the debt and stated that it is in process of settling the dues of the Financial Creditor. The Corporate Debtor, on April 13, 2017 sent a One-time Settlement (**"OTS"**) proposal to the Financial Creditor and the said OTS proposal was accepted by the Financial Creditor on certain terms and conditions by its letter dated July 3, 2017. However, the letter dated April 13, 2017 is not on record.

The said OTS period was also extended by the Financial Creditor by its letter dated August 28, 2017 at the request of the Corporate Debtor. However, the Corporate Debtor failed in repayment of the amount as per the OTS proposal and hence, the Financial Creditor by its letter dated November 22, 2017 cancelled the said OTS proposal and initiated recovery proceedings under Section 19 of the Recovery of Debts and Bankruptcy Act, 1993 and also under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (**"SARFAESI Act"**) but the proceedings did not reach to a logical end. Therefore, the Financial Creditor filed an application under Section 7 of the IBC on March 15, 2019.

The Adjudicating Authority by order dated July 5, 2019 admitted the application to initiate the corporate insolvency resolution process (**"CIRP"**) against the Corporate Debtor, issued moratorium and appointed Mr. Radha Krishnan Dharamrajan as the interim resolution professional. Being aggrieved by the said order, Mr. R.R. Gopaljee, promoter and shareholder of the Corporate Debtor filed an appeal before the NCLAT under Section 61(1) *(appeals and appellate authority)* of the IBC.

Issue

Whether the letter dated March 27, 2017 be treated as an acknowledgment of debt in terms of Section 18 of the Limitation Act, 1963 (**"Limitation Act"**) in absence of any specific acknowledgment of liability by the Corporate Debtor.

Arguments

The submission of the counsel for the appellant were:

i. The Adjudicating Authority did not observe the principal of natural justice and passed the order without providing an opportunity to file objections on the application under Section 7 of IBC.

ii. The correct date of NPA is not clear as the Financial Creditor in the notice sent under Section 13(2) of the SARFAESI Act, 2002 mentioned the NPA date as June 30, 2015 whereas, in the additional affidavit filed before the Adjudicating Authority, the NPA date is disclosed as April 1, 2015.

iii. The debt is time barred as the application under Section 7 is filed on March 15, 2019.

iv. The Adjudicating Authority wrongly relied upon the letter dated March 27, 2017 as an acknowledgment of debt, as the said letter only states that the Corporate Debtor will settle issue with the Financial Creditor and that there is no specific acknowledgment of debt. Also, for the purpose of acknowledgment of debt, the exact amount of debt due and the timeline for payment has to be specifically admitted and clearly stated.

v. High Court of Delhi in the Case of ***Dorham Carelline India Limited. v. Studio Line [2009 DLT 123]*** held that Section 18 of Limitation Act requires: (i) An admission or acknowledgement; (ii) that such acknowledgement must be in respect of a property or right; (iii) that it must be made before the expiry of limitation; (iv) that it should be in writing and signed by the party against whom such property or right is claimed. None of these conditions were fulfilled by the letter dated March 27, 2017.

vi. The Supreme Court of India (**"SC"**) in the case of ***State of Kerala v. T.M. Chackoo, [(2000) 9 SCC 722]*** held that *"The person acknowledging must be conscious of his liability and commitment should be made towards that liability. It need not be specific, but if necessary facts which constituted the liability are admitted, an acknowledgement may be inferred from such an admission."*

As the letter dated March 27, 2017 does not specify any commitment towards the liability and is merely a reply stating certain meetings with the officials of the Financial Creditor, it cannot be treated as an acknowledgment.

The submission of the counsel for Financial Creditor was that as the Corporate Debtor defaulted in repayment of the loan, a legal notice dated March 15, 2017 was sent to it and the Corporate Debtor replied to the said notice on March 27, 2017 wherein it acknowledged the claim. Thereafter, the Corporate Debtor sent an OTS proposal which was accepted by the Financial Creditor. However, the Corporate Debtor failed to repay the loan and therefore, an application under Section 7 of the IBC was filed.

Observations of the NCLAT

In the additional affidavit filed on behalf of the Financial Creditor, date of default is shown as April 1, 2015. However, in the notice under Section 13(2) of the SARFAESI Act, 2002, the NPA date is shown as June 30, 2015. The

Adjudicating Authority considered the objection and held that according to the Corporate Debtor, the Financial Creditor declared its account as NPA on June 30, 2015 and the NCLAT agreed with the said finding of the Adjudicating Authority.

Further, the Application under Section 7 of IBC was filed on March 15, 2019, that is, after three years from the date of default. Therefore, the question for consideration is whether the Corporate Debtor has acknowledged the debt as per the requirement under Section 18 of the Limitation Act, only then, the date of default can be forwarded to a future date as held by the NCLAT in ***Sh. G Eswara Rao v. Stressed Assets Stabilisation Fund [Company Appeal (At) (Ins) No. 1097 of 2019].***

The SC in the case of ***J.C. Budhraja v. Chairman Orissa Mining Corporation Limited [(2008) 2 SCC 444]*** held that Section 18 of the Limitation Act, deals with the effect of acknowledgment in writing and provides that a fresh period of limitation shall be computed from the time when the acknowledgment was signed before the expiration of the prescribed period for a suit or application in respect of a right. The explanation to the section provides that an acknowledgment may be sufficient though it omits to specify the exact nature of the right or avers that the time for payment has not yet come or is accompanied by a refusal to pay, or is coupled with a claim to set off, or is addressed to a person other than a person entitled to the right.

Further in the case mentioned above, a reference is also made of the SC's ruling in the case of ***Shapoor Freedom Mazda v. Durga Prosad Chamaria [AIR 1961 SC 1236]*** wherein the SC stated that words used in the acknowledgment must indicate existence of jural relationship between the parties such as that of debtor and creditor, and it must appear that the statement is made with the intention to admit such jural relationship.

Making a reference from the SC's ruling in the above said case, the NCLAT further stated that it is now well settled that a writing to be an acknowledgement of liability must involve an admission of subsisting jural relationship between the parties and a conscious affirmation of an intention of continuing such relationship in regard to an existing liability. The admission need not be in regard to any precise amount nor by expressed words. The SC in the aforesaid judgment also held that in construing words used in the statement made in writing on which a plea of acknowledgement rest, oral evidence has been expressly excluded but surrounding circumstances can always be considered. It is also held that the statement on which a plea of acknowledgement is based must relate to a person's subsisting liability though the exact nature or the specific character of said liability may not be indicated in words.

Thereafter, in reference to the principal laid down in the above case, the NCLAT examined the case in hand and stated that the Corporate Debtor in its reply dated March 27, 2017 to the demand notice, admitted the jural relationship between the parties and a conscious affirmation of an intention of continuing such relationship in regard to an existing liability.

The Corporate Debtor in its reply to the demand notice did not dispute the amount and admitted the liability and stated that it is in process of settling the dues of Financial Creditor. Subsequent to the same, on April 13, 2017, the

Corporate Debtor also sent an OTS proposal to the Financial Creditor and on July 3, 2017 the same was accepted by the Financial Creditor on certain terms and conditions. An extension for time of payment was also granted by the Financial Creditor. However, the Corporate Debtor failed to make the payment and the said OTS proposal was revoked by the Financial Creditor on November 22, 2017. The NCLAT observed that it is true that the letter dated April 13, 2017 is not on record, however, the Corporate Debtor does not deny that it had not sent an OTS on April 13, 2017 to the Financial Creditor.

On the basis of the above discussion, the NCLAT held that it is proved that Corporate Debtor had acknowledged the debt within three years, that is, before the expiration of the prescribed period for a suit or application.

Decision of the NCLAT

The NCLAT upheld the admission order passed by the Adjudicating Authority under Section 7 of IBC as the same was well within limitation and hence, the appeal was dismissed.

VA View:

In the present case, the Corporate Debtor contended that the letter by which it offered to settle the dues of the Financial Creditor cannot be treated as an acknowledgment of debt as there was no specific acknowledgment of debt in the letter and neither the exact amount of debt due was admitted in the said letter.

However, the NCLAT rejected this contention of the Corporate Debtor and stated that the said letter admitted the jural relations between both the parties and a conscious affirmation of an intention of continuing such relationship in regard to an existing liability. Even though the said letter made no express acknowledgment of debt but the NCLAT emphasised that it is the intent of the parties which will determine the nature of the acknowledgment and that the admission need not be with regard to any precise amount nor by expressed words, if the intent is clearly established and thus by virtue of Section 18 of the Limitation Act, the limitation period would be extended.

Also, it can be inferred from the subsequent letters exchanged between both the parties, wherein an OTS was arrived, that the Corporate Debtor was aware of the debt and had also shown its intent to settle the same. The said intent can very well be treated as an admission of debt as the execution of an OTS makes it clear that the Corporate Debtor was conscious of its liability towards the Financial Creditor and made a commitment to clear the same.

III. Supreme Court: The appellant's plea on limitation was illusory; the date of execution of sale deed was deliberately excluded to overcome limitation and mislead the court

The Supreme Court of India (**"SC"**) by its judgement in ***Dahiben v. Arvindbhai Kalyanji Bhanusali through Legal Representative and Others [Civil appeal no. 9519 of 2019]*** *(decided on July 9, 2020)* upheld the order of the Gujarat High Court (**"GHC"**) affirming the decision of the trial court which had allowed the application of respondent nos. 2 and 3 under Order VII Rule 11 (a) and (d) of the Civil Procedure Code, 1908 (**"CPC"**). The said

application had been filed by the said respondents for rejecting the plaint presented by the appellant towards cancellation of a sale deed.

Facts

Cancellation of a sale deed had been sought in respect of certain premises located in Village Mota, Surat (**"Suit Property"**), which was under restrictive tenure and hence covered under Section 73AA *(restriction on transfer of occupancies of tribals to tribals or non-tribals)* of the Land Revenue Code (**"Land Revenue Code"**). The appellant, being the owner of the Suit Property, filed an application before the Collector of Surat to obtain permission to sell the Suit Property to respondent no. 1 and recorded their NOC for the same. The Collector permitted the sale and after carrying out title verification and other procedures stipulated under the Land Revenue Code, fixed the sale price to be INR 1,74,02,000 (Indian Rupees One Crore Seventy-Four Lakhs Two Thousand only). It was decided that the purchaser, that is, respondent no. 1, would make payment by cheque and reference to the same would be made in the sale deed.

Hereinafter, the sale was carried out by a registered deed of sale dated July 2, 2009 (**"Sale Deed"**). Respondent No. 1 had issued 36 (thirty six) cheques pursuant to the same, the details of which were also recorded in the Sale Deed. Subsequently, respondent no. 1 sold the Suit Property to respondent nos. 2 and 3 for an amount of INR 2,01,00,000 (Indian Rupees Two Crores One Lakh only) by a registered deed of sale dated April 1, 2013. On December 05, 2014, the appellant filed a civil suit before the Principal Civil Judge, Surat wherein she impleaded both the original (respondent no. 1) and subsequent purchasers (respondent nos. 2 and 3), and prayed that the Sale Deed dated July 2, 2009 be set aside, on account of non-payment of the entire sale consideration by respondent no. 1.

Issues

The trial court had identified the following issues:

(i) Whether there was a cause of action in the plaint.

(ii) Whether the suit was barred by limitation.

Arguments

Contentions of the appellant:

The appellant had stated in the plaint that the Sale Deed should be cancelled on the grounds that it was illegal, void and not binding as the entire consideration amount had not been paid by respondent no. 1. The appellant alleged that respondent no. 1 had paid only INR 40,000 (Indian Rupees Forty Thousand only) through 6 (six) cheques and the remaining 30 (thirty) cheques issued for INR 1,73,62,000 (Indian Rupees One Crore Seventy Three Lakhs Sixty Two Thousand only) were bogus and further, prayed for the restoration of the Suit Property.

As a corollary, the appellant also prayed for cancellation of the subsequent sale deed dated April 1, 2013 entered into by respondent no. 1 with respondent nos. 2 and 3 for the Suit Property.

Contentions of respondent nos. 2 and 3:

Respondent nos. 2 and 3 thereafter, applied for rejection of the appellant's plaint under Order VII Rule 11 (a) and (d) *(rejection of plaint)* of the CPC stating that the appellant's plea was barred by limitation and that no cause of action was disclosed by the appellant as such. They made further submissions as follows:

a. The appellant had already admitted the execution of the Sale Deed before the Sub-Registrar, Surat.

b. The cause of the appellant was barred by limitation as it should have been filed within 3 (three) years of the date of Sale Deed, that is, on or before July 1, 2012.

c. The appellant had participated in the proceedings before the Revenue Officer for transfer of the Suit Property in the revenue records in favor of the respondent no. 1. Further, before confirming the entry into the record of rights (or 'Hakk Patrak') for transfer of the Suit Property in favor of respondent no. 1, a notice under Section 135D *(register of mutations and register of disputed cases)* of the Land Revenue Code had been served on the appellant and ever since then respondent no. 1 has been paying the land revenue for the same.

d. Respondent nos. 2 and 3 had purchased the Suit Property from respondent no. 1 after conducting due verification of title reports and inspection of revenue records. They had purchased the Suit Property by paying consideration for the amount of INR 2,01,00,000 (Indian Rupees Two Crores and One Lakh only) by the sale deed dated April 1, 2013. Pursuant to this, the names of respondent nos. 2 and 3 were entered into in the revenue records.

e. In order to mislead the court, the appellant had produced a 7/12 extract dated July 20, 2009 (which was prior to the mutation in favor of respondent no. 1).

Observations

Observations of the trial court:

On perusal of the Sale Deed, it was noted that the appellant had in fact accepted and acknowledged the payment of the full sale consideration from respondent no.1, through cheques which were issued prior to the execution of the Sale Deed, during the period between July 07, 2008 and July 2, 2009. The court held that had the appellant not been able to encash 30 (thirty) cheques, a complaint ought to have been filed, or proceedings should have been initiated for recovery of the unpaid sale consideration. There was however, nothing on record to show that the appellant had made any complaint in this regard for a period of over 5 (five) years.

The appellant had also failed to produce the returned cheques, passbooks, bank statements, or any other document to support averments made in the plaint. The court observed that the lack of action on part of the appellant for over 5 (five) years after execution of Sale Deed meant that the averment in the plaint could not be considered. The cause of action had arisen when respondent no.1, had issued bogus cheques in 2009. Herein, as per the provisions of the Limitation Act, 1963 (**"Limitation Act"**) the suit should have been filed by 2012.

The trial court, on the basis of the settled position in law, held that the suit of the appellant was barred by limitation, and allowed the application of respondent nos. 2 and 3 under Order VII Rule 11(d) CPC, hence rejecting the plaint.

Observations of the Gujarat High Court:

Aggrieved by the findings of the trial court, the appellant approached the GHC. The division bench of the GHC found that there was no dispute regarding the execution of the Sale Seed and its subsequent conveyance. In the said Sale Deed, it was admitted and acknowledged by the appellant that full sale consideration had been received. In fact, the Sale Deed had complete particulars with respect to payment of sale consideration by way of 36 (thirty six) cheques. The Suit Property was successfully transferred to respondent no. 1 and hence the said Sale Deed could not be held bad in law. The court also concurred with the view of the trial court that suit was barred by limitation. Further, the court stated that since the appellant had made no averments against the respondent nos. 2 and 3, there was no privity of contract between them.

Observations of the Supreme Court:

Aggrieved by the decision of the GHC, the appellant was constrained to appear before the SC. The SC examined the scope of Order VII Rule 11 of the CPC which dealt with rejection of a plaint. It was noted that the power to terminate a civil suit was a drastic one and hence the procedure laid down in Order VII Rule 11 must be followed strictly.

The SC had laid down a test for the application of Order 7 Rule 11 of the CPC. The plaint which is presented to the court has to be read in its entirety along with the documents that are relied upon, basis which it is to be determined if a decree can be passed. If on a meaningful reading of the plaint, it was found that the suit was manifestly vexatious and without any merit, and did not disclose a right to sue, the court would be justified in exercising the power under Order VII Rule 11 of the CPC.

The case as per the plaint was that even though the Sale Deed was executed for a consideration of INR 1,74,02,000 (Indian Rupees One crore Seventy Four Lakhs and Two Thousand only), only INR 40,000 (Indian Rupees Forty Thousand only) was paid to the appellant at the time. Whereas the averments in the plaint are completely contrary to the recitals in the plaint which record that the entire sale consideration was “paid” by respondent no. 1 during the period between July 7, 2008 and July 7, 2009. Even if the case of the appellant was to be believed, it was inconceivable that the payments had remained unpaid and the appellant would have been completely silent for a period of over 5 (five) years without even issuing a legal notice/ instituting recovery proceedings for the unpaid sale consideration.

Further, reliance was placed upon ***Vidyadhar v. Manikrao and Another [(1999) 3 SCC 573)]*** wherein it was held that the words “price paid or promised or part paid and part promised” indicated that actual payment of the whole of the price at the time of the execution of the Sale Deed was not a sine qua non for completion of the sale. Even if the whole of the price had not been paid, but the document had been executed, and thereafter registered,

the sale would be complete, and the title would pass on to the transferee under the transaction. The non-payment of a part of the sale price would not affect the validity of the sale. Once the title in the property has already passed, even if the balance sale consideration is not paid, the sale could not be invalidated on this ground.

Decision of the Supreme Court

The SC held that even if the averments of the appellant were true and the entire sale consideration had not been paid it would not be a ground for cancellation of the Sale Deed. The plea that the fraud was learnt in 2014 on receipt of the index of the Sale Deed was misconceived and would not be a cause of action. The plea was illusory, and was only intended to overcome the period of limitation.

The appellant deliberately did not mention the date of the registered Sale Deed dated July 2, 2009 since it would be evident that the suit was barred by limitation. The prayer however mentioned the date of the subsequent sale deed dated April 1, 2013 when the suit property was later sold to respondent nos. 2 and 3. The omission of execution of the Sale Deed dated July 2, 2009 in the prayer clause, was done deliberately and knowingly, so as to mislead the court on the issue of limitation.

Further, the suit filed by the appellant was held to be vexatious, meritless and not disclosing a right to sue. Thus, the SC upheld the decision of the GHC and trial court in rejecting the plaint of the appellant in accordance with Order VII Rule 11 (a) and (d) of the CPC.

VA View:

The instant case is an example of misrepresentation by the plaintiffs who hid crucial information and tried to mislead the Court, creating an illusion of the existence of cause of action, despite it being barred by the statute of limitation.

It is pertinent to note that even though the limitation in this case was 3 (three) years, the appellant had filed their suit after a period of 5 (five) years from the execution of the Sale Deed, stating non-payment of consideration. As far as rejection of a plaint is concerned which is the essence of this judgement, Order VII, Rule 11 of the CPC deals with various circumstances in respect of such rejection. The aforestated provision is pivotal in the sense that it saves the time of the Court from frivolous and vexatious litigation. Further, these provisions are mandatory in nature, and make use of the words, “The plaint shall be rejected in the following cases…”

Upholding the application of respondent nos. 2 and 3 under the aforesaid provisions of CPC, the SC rejected the plaint as: (a) no cause of action could be made out and (b) suit was barred by limitation. The SC had acted upon the settled principle of law to hold that there is no merit to the argument of the appellant and the plaint could not be entertained as it fell under Order VII Rule 11 of the CPC.

IV. NCLAT: The occurrence of a default, and not the inability to pay debt is relevant for admitting or rejecting an application for initiation of CIRP under the IBC

The National Company Law Appellate Tribunal (**"NCLAT"**) in the case of ***Monotrone Leasing Private Limited v. PM Cold Storage Private Limited*** *(decided on July 6, 2020)* has held that the inability to pay-off debts and committing default are different aspects which are required to be adjudged on equally different parameters, and that ascertaining commission of default is important when assessing applications to initiate Corporate Insolvency Resolution Process (**"CIRP"**) rather than the ability to pay.

Facts and Arguments

Monotrone Leasing Private Limited (**"Appellant"**) filed an application under Section 7 of the Insolvency and Bankruptcy Code, 2016 (**"IBC"**) against the PM Cold Storage Private Limited (**"Respondent"**) for initiation of CIRP on the ground that the Respondent committed default in repaying a financial debt of INR 27,19,110.

The Appellant contends that it had lent a sum of INR 25 lacs to the Respondent for 90 days, on which interest was to be charged at the rate of 15% per annum. The Respondent acknowledged receipt of the same by a letter dated June 14, 2017 which further stated the terms of the transaction. The Respondent issued a post-dated cheque on September 12, 2017 for a sum of INR 25 lacs drawn on State Bank of India in favor of the Appellant. But, even after September 12, 2017 the loan transaction between the parties was extended for a further period of one year. Subsequently, the Respondent handed over a post-dated cheque of INR 25 lacs dated October 09, 2018, which was dishonored.

A notice under Section 138 of the Negotiable Instruments Act, 1881 was served upon Respondent on November 01, 2018. The Respondent contended that no debt is due and payable to the Appellant, as the amount borrowed from it had been "squared off" due to a large number of transactions between the parties after which a civil suit was initiated for the recovery of the alleged amount. Subsequently, the Appellant filed for an application to initiate CIRP under Section 7 of the IBC before the National Company Law Tribunal, Kolkata (**"NCLT"**).

The NCLT rejected the application on the ground that the NCLT cannot act as a recovery tribunal, especially as the Appellant could not produce the required documents to show that it received any application from the Respondent for the loan. The Appellant did not produce the record of default from the information utility which is required under Section 7(3)(a) of the IBC.

The NCLT further noted that the competent civil court having jurisdiction found that there exists a prima facie case in favor of the Respondent and has issued interim prohibitory order against the Appellant restricting the Appellant from recovering the amount claimed herein. It further noted that the Respondent has filed a financial statement showing a balance of more than INR 25 lacs which shows that it is a solvent company. This was subsequently appealed by the Appellant before the NCLAT.

Issue

Whether the application under Section 7 of the IBC is maintainable.

Observations of the NCLAT

An adverse inference was drawn against the Appellant on account of non-submission of documents required for obtaining a loan from an NBFC. However, it was also observed that the NCLT is expected to admit or reject an application for initiation of CIRP solely on the basis of parameters laid down under Sections 7,9 or 10 of the IBC.

It was held that the NCLT failed to appreciate that the issuance of cheque also gives an unconditional admission on behalf of the Respondent towards the debt of the Appellant. Thus, the adverse inference drawn by the NCLT for not submitting any explanation regarding the earlier cheque dated September 12, 2017 was held to be without any basis.

It was observed that the Supreme Court of India had, in the case of ***Innoventive Industries Limited v. ICICI Bank [(2018) 1 SCC 407],*** laid down the guiding principles to admit or reject an application filed under Section 7 of the IBC. The Supreme Court of India had held that, to admit an application, the NCLT is to be satisfied that a default has occurred and that the corporate debtor is entitled to point out that a default has not occurred in the sense that the "debt", which may also include a disputed claim, is not due. A debt may not be due if it is not payable in law or in fact. The moment the NCLT is satisfied that a default has occurred, the Application must be admitted unless it is incomplete.

The application filed by the Appellant under Section 7 of the IBC, read with Rule 4 of the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016, was held to be complete. In the circumstances, it is clear that the observation of the NCLT is sans any evidence.

One of the grounds of rejection taken by the NCLT is that the Respondent is a solvent company as the financial statement of the Respondent in the financial year ending March 2017 depicts revenue from operation in the Respondent's account as INR 34,13,351 and a balance of more than INR 25 lacs. The NCLAT emphasized that a presumption cannot be drawn merely on the basis that a company, being solvent, cannot commit any default. As observed in financial and economic parlance, the inability to pay-off debts and committing default are two different aspects which are required to be adjudged on equally different parameters. Inability/ability to pay debt has no relevance for admitting or rejecting an application for initiation of CIRP under the IBC.

It was stated that the judgement of the Supreme Court of India in ***Swiss Ribbons Private Limited v. Union of India [(2019) 4 SCC 17]*** clarifies that rather than the "inability to pay debts", it is the "determination of default" that is relevant for allowing or disallowing an application filed under Sections 7,9 or 10 of IBC. The said shift enables an applicant to prove by documentary evidence that there was an obligation to pay the debt and that the debtor has failed to fulfill its repayment obligations. Therefore, to allow the application under Section 7, it is not relevant to see the inability of the corporate debtor (in this case, Respondent) to pay the debt.

It was observed by the NCLT that the civil court has issued an interim prohibitory order against the Appellant and others stating that they cannot recover the amount claimed. The Respondent has failed to file any such order of the civil court prohibiting realization of the said amount. However, it is to be clarified thatby the non-obstante clause in Section 238 of the IBC, the IBC has an overriding effect over any other law that is inconsistent with it. Therefore, the civil court was not competent to issue an injunction order for a case pending under the IBC. It was observed that the NCLT has erred in rejecting the application based on the pendency of civil suit between the parties.

Decision of the NCLAT

The application under Section 7 of the IBC was admitted and the CIRP was initiated for the Respondent, as the NCLAT was satisfied that a default had taken place.

VA View:

This judgement clarifies an important position of law, and holds that the financial ability of an entity is not relevant when ascertaining if CIRP should be initiated. The only aspect that the NCLT has to determine while admitting a company into CIRP is whether a default in repayment has occurred.

Therefore, with regards to financial credit, borrowers must strive to repay their loans as and when they are due, and cannot take shelter in the fact that they are solvent and have the financial resources to repay the amount due to protect themselves from CIRP.

With regard to the adverse inferences drawn by the NCLT on the Appellant on account of non-submission of documents required to avail of a loan from an NBFC and for not providing explanation regarding earlier cheque dated September 12, 2017, the NCLAT has clearly defined the parameters on which an application to initiate the CIRP is to be judged.

Further, the ruling of the NCLAT with regard to the interim prohibitory order issued by the civil court is to be appreciated, as such orders can frustrate and hinder the CIRP process and that the IBC, being a complete code by itself and pursuant to non-obstante provision contained in Section 238 of the IBC, should prevail.

Contributors:

Ajita Patnaik, Drushan Engineer, Ishita Mishra, Netra Nair and Parth Mishra.

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
105-106, Raheja Chambers,
#12, Museum Road,
Bengaluru 560001, India
Phone: +91-80-40903588 /89
Fax: +91-80-40903584
bangalore@vaishlaw.com