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Key Highlights

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I. The Permanent Court of Arbitration, Hague: The Indian Government's imposition of tax liability along with the interest and penalty on Vodafone, pursuant to a retrospective amendment made in the Income-tax Act, 1961, was in violation of the bilateral investment treaty signed between India and Netherlands

The Permanent Court of Arbitration, Hague (**"PCA"**) has in its award released on September 25, 2020 (**"Award"**) in the matter of ***Vodafone International Holdings BV v. The Republic of India [PCA Case No. 2016 - 35]*** held that, the Indian Government's imposition of tax liability along with interest and penalty on Vodafone International Holdings BV, Netherlands (**"Vodafone"**), pursuant to a retrospective amendment in the Income-tax Act, 1961 (**"IT Act"**), notwithstanding the Supreme Court judgement in favour of Vodafone, was in violation of Article 4(1) of the Bilateral Investment Promotion and Protection Agreement between India and Netherlands (**"India-Netherlands BIPA"**) signed in 1995.

A. Background:

i. Transaction in dispute and the Income-tax Department's contentions:

In 2007, Vodafone (incorporated in Netherlands) had acquired entire share capital of CGP Investments (Holdings) Ltd. (**"CGP"**) (incorporated in Cayman Islands) from Hutchinson Telecommunication International Ltd. (**"Hutch"**) (incorporated in Cayman Islands). CGP had a controlling interest in Hutchinson Essar

Ltd. (**"HEL"**), an Indian company and a prominent player in the Indian telecom sector. In essence, Vodafone International indirectly acquired controlling interest in HEL.

Prima facie, since the buyer and seller were non-residents and since the capital asset (share of CGP) was situated outside India, no tax liability could have arisen in India in relation to the income (capital gain)arising pursuant to the transaction.

The Indian Revenue, however, was of the view that since the above transaction resulted in extinguishment of certain rights of Hutch in HEL and, alternatively in indirect transfer of assets in India, capital gains chargeable to tax in India arose, and Vodafone was thus under an obligation to withhold tax at source while making the payment of the sale consideration, in terms of Section 195 of the IT Act.

ii. Vodafone's writ petition before the Bombay High Court:

Vodafone filed a writ petition before the Hon'ble Bombay High Court (**"BHC"**) challenging the action of the Income-tax Department. However, the BHC ruled in favour of the Income-tax Department[1], against which Vodafone preferred an appeal to the Supreme Court of India (**"SC"**).

iii. Vodafone's appeal before the Supreme Court:

The SC by its decision dated January 20, 2012 decided the matter in favour of Vodafone and held that offshore transaction of acquisition of shares was a bonafide, structured Foreign Direct Investment (**"FDI"**) in India which fell outside India's Revenue's territorial tax jurisdiction and hence was not taxable. Accordingly, it was held that Vodafone was not liable to withhold tax under Section 195 of the IT Act and the tax demand was quashed[2].

iv. Retrospective amendment to nullify the Supreme Court judgement:

To neutralize/ nullify the effect of the aforesaid judgement of the SC, the Indian Parliament, vide the Finance Act, 2012, made retrospective amendments to various provisions of the IT Act including Section 9(1)(i) of the IT Act, which in turn, empowered the Income-tax Department to tax such indirect transfers of shares, including the aforesaid transaction.

B. Vodafone's resort to arbitration under the India-Netherlands BIPA:

Being aggrieved by the retrospective amendments to the IT Act, Vodafone served a notice of dispute to the Indian Government on April 07, 2012, and invoked the arbitration pursuant to the provisions of the India-Netherlands BIPA.

The India-Netherlands BIPA was signed on November 06, 1995, enforced on December 05, 1996 and terminated on September 22, 2016[3]. Its aim was to extend and intensify the economic relations, promotion and protection of cross-border investment of the companies, and reciprocal protection of investments along with fair and equitable treatment to be accorded to the investors of one contracting party in the territory of other. While the government

1 Vodafone International Holdings B.V. v. Union of India: (2010) 329 ITR 126 (Bombay)

2 Vodafone International Holdings B.V. v. Union of India: (2012) 341 ITR 1 (SC)

3 As per information available on the website of the Department of Economic Affairs, Ministry of Finance at https://www.dea.gov.in/bipa

was continuing to oppose the arbitration, Vodafone's parent company, Vodafone Group Plc (United Kingdom) served another notice of dispute and notice of arbitration upon the Indian Government under the Bilateral Investment Promotion and Protection Agreement between India and United Kingdom (**"India–United Kingdom BIPA"**). The Vodafone group contended that it intends to obtain at least one route to an arbitral forum.

The Indian Government challenged the second notices of dispute and arbitration through a civil suit before the Hon'ble Delhi High Court on account of abuse of arbitral process. However, the Hon'ble Delhi High Court finally dismissed the suit[4], basis the interpretations of the BIPAs and on consideration of Vodafone's intention to consolidate the arbitrations thus negating the possibility of multiple proceedings.

Under the India-Netherlands BIPA, the investment dispute was referred to a three-member arbitral tribunal to resolve the dispute as per Article 9(3)(c) read with Article 9(4) of the India-Netherlands BIPA and in accordance with the Arbitration Rules of the United Nations Commission on International Trade Law, 1976.

C. Order of the PCA in the arbitration proceedings under the India-Netherlands BIPA:

Reportedly[5], the PCA in its order dated September 25, 2020 held that the imposition of tax along with interest and penalties by the Indian Government, notwithstanding the Supreme Court judgement, was in breach of the guarantee of fair and equitable treatment laid down in Article 4(1) of the India-Netherlands BIPA.

The PCA noted that under the terms of India-Netherlands BIPA, it had jurisdiction to consider Vodafone's claim for breach of the India-Netherlands BIPA. It also observed that any failure by the Indian Government to comply with the directive will engage India's international responsibility.

Consequently, PCA ordered the Indian Government, *inter alia,* to reimburse to Vodafone a sum of approximately INR 850 million (£ 4.32 million).

If at all the complete order of the PCA is released in public domain, it would be interesting to note:

i. On what reasoning did the PCA overcome the jurisdictional challenge raised by the Indian Government regarding inapplicability of Article 4(1) of the India-Netherlands BIPA on tax disputes (in view of the bar prescribed under Article 4(4) of the India-Netherlands BIPA)?

ii. How the term "fair and equitable" has been interpreted by the PCA to hold that the conduct of the Indian Government breached Article 4(1) of the India-Netherlands BIPA?

iii. In the decision paragraph of the order, the PCA has noted that the conduct of the Indian Government in respect of imposition of tax liability on Vodafone, notwithstanding the Supreme Court judgement, is in breach of Article 4(1)of the India-Netherlands BIPA. Whether a retrospective amendment in general, when it does not nullify any

4 Union of India v. Vodafone Group Plc United Kingdom and Another: CS (OS) 383/2017 & I.A.No. 9460/2017

5 As on date, the complete order of PCA in this case is not available in public domain. Only an extract comprising paragraph"XIV. Decision" has been reported by a media platform.

judgement of the Supreme Court, would also be treated as a breach of the guarantee of "fair and equitable" treatment?

D. Recourse available to the Indian Government

Vide press release dated September 25, 2020, the Central Board of Direct Taxes (**"CBDT**") has stated that the Indian Government would be studying the award and thereafter, would take a decision on further course of action including legal remedies before appropriate fora. Few developments also suggest that the High Court of Delhi has also asked the Indian Government to inform whether it wants to abide by or challenge the arbitral award.

VA View:

Although the award is not binding on third parties, it may have a persuasive value in similar arbitrations instituted or to be instituted by other assessees. If the decision of the Tribunal renders any findings on the legality of retrospective amendments qua the fair and equitable treatment clause in bilateral treaties, then it is to be seen whether the said conclusions can have far reaching impacts on other assessees. Additionally, the power to levy taxes has been universally acknowledged as an essential attribute of sovereignty. However, imposing taxes retrospectively does deter and discourage investor sentiments and creates unforeseen liability for assessee. If the Indian Government decides to accept the award, it may probably encourage fresh investments and renewed trust into India, more so at a time when the global geopolitical relationship with China is undergoing a rapid and perhaps permanent transformation.

II. Supreme Court: (i) The merits of the arbitral award are not open to review by the enforcement court, which lies within the domain of the seat courts (ii) The period of limitation for filing a petition for enforcement of a foreign award is three years

The Hon'ble Supreme Court of India (**"SC"**) has in its judgment dated September 16, 2020 (**"Judgment"**) in the matter of ***Government of India v. Vedanta Limited and Others [Civil Appeal No. 3185 of 2020],*** held that the period of limitation for filing a petition for enforcement of a foreign award under Sections 47 and 49 of the Arbitration and Conciliation Act, 1996 (**"1996 Act"**), would be governed by Article 137 of the Limitation Act, 1963 (**"Limitation Act"**) which prescribes a period of three years from when the right to apply accrues. The SC also held that the enforcement court exercising jurisdiction under Section 48 of the 1996 Act, cannot refuse enforcement by taking a different interpretation of the terms of the contract.

Facts

The civil appeal had been filed by the Government of India (**"Appellant"**) to challenge the judgment and order dated February 19, 2020 passed by the Delhi High Court (**"DHC"**), wherein the application under Section 48 of the 1996 Act filed by the Appellant had been dismissed; while the applications filed under Section 47 read with Section 49 of the

1996 Act for the enforcement of the foreign award, and Section 5 of the Limitation Act, for condonation of delay in filing the execution petition by the respondents, were allowed.

In 1993, the Appellant floated a global competitive tender to invite bids for the purposes of exploring and developing the petroleum resources in the Ravva Gas and Oil Fields (**"Ravva Field"**). Pursuant thereto, Videocon International Limited and Command Petroleum Holdings NV, submitted their bid to develop the Ravva Field. The contract for this petroleum development was to be given on a production sharing basis through a Production Sharing Contract (**"PSC"**), which was for a period of 25 years, executed on October 28, 1994, between the Appellant and the following parties:

(a) Command Petroleum (India) Pvt. Ltd. *(later renamed as Cairn Energy India Pvt. Ltd);*

(b) Ravva Oil (Singapore) Pty. Ltd;

(c) Videocon Industries Limited; and

(d) Oil and Natural Gas Corporation Limited (**"ONGC"**).

Parties (a),(b) and (c) are collectively referred to as the "Respondents". The development and exploration of the Ravva Field was to be conducted in terms of the 'Ravva development plan' which, *inter alia,* contemplated the drilling of 19 oil and 2 gas wells in the Ravva Field. The dispute emanated from Article 15 of the PSC which provides for recoverability of base development costs, incurred by the Respondents for the development of Ravva Field.

On 18.08.2008, the disputes were referred to arbitration under Article 34 of the PSC. The tribunal held that the Respondents were entitled to recover USD 278,871,668 from the 'cost petroleum towards development costs' incurred by the Respondents for the period 2000-01 to 2008-09. Consequently, on 15.04.2011, the Appellant challenged the award under Section 37 of the Malaysian Arbitration Act, 2005 before the Malaysian High Court, on grounds of dealing with a dispute not falling under the terms of submission to arbitration, conflict with public policy and excess jurisdiction. The Malaysian High Court by order dated 30.08.2012 rejected the challenge to the award holding that the requirements of Sections 37(1)(a)(iv) and (v) and Section 37(1)(b)(ii) of the Malaysian Act have not been met. Aggrieved by this, the Appellant preferred an Appeal before the Malaysian Court of Appeal, which was dismissed by order dated 27.06.2014, holding that the tribunal had given effect to the agreement between the parties under the terms of the PSC and there was no determination by the tribunal which was outside the submissions of the parties. An application for leave to appeal filed by the Appellant before the Malaysian Federal Court was rejected by order dated 17.05.2016.

During the pendency of the application for leave to appeal, the Respondents filed a petition for enforcement under Section 47 read with Section 49 of the 1996 Act before the DHC, along with an application for condonation of delay. The Appellant filed an application under Section 48 of the 1996 Act before the DHC, *inter-alia,* on the grounds that the enforcement petition was filed beyond the period of limitation; the enforcement of the award was contrary to the public policy of India, and contained decisions on matters beyond the scope of the submission to arbitration. The DHC rejected the petition under Section 48 of the 1996 Act filed by the Appellant, but allowed the application for

condonation of delay filed by the Respondents, and directed the enforcement of the award. Consequently, the Appellant approached the SC.

Issues

(i) Whether the petition for enforcement of the foreign award was barred by limitation.

(ii) Whether the foreign award is in conflict with the public policy of India.

Arguments

Contentions raised by the Appellant:

On Issue (i): It was submitted that the DHC erroneously held that an application for enforcement of an arbitral award would be governed by the limitation period of 12 years under Article 136 of Limitation Act, by citing ***Bank of Baroda v Kotak Mahindra Bank [2020 SCC OnLine SC 324],*** wherein it was held that a foreign award could not be treated to be a decree of a civil court. It was submitted that, since there is no specific provision in the Limitation Act for enforcement of foreign awards, it would necessarily fall under the residuary provision, that is, Article 137 of the Limitation Act, and that the right to apply would accrue from the date of making the award. The award was passed on 18.01.2011, and the petition for enforcement / execution was filed by the Respondents on 14.10.2014. The petition was barred by 268 days beyond the period of limitation. It was submitted that the reasoning of the DHC is contrary to the 1996 Act, since it has ignored the provision under Section 49 of the 1996 Act to ensure that the foreign award is enforceable. A foreign award has no legal sanctity, until an affirmative decision is obtained under Section 48 of the 1996 Act. It was submitted that the foreign award does not transform into a decree of a civil court in India and that the foreign award does not lose its character as an arbitral award. It is only presumed to be a decree of the court for the purposes of execution.

On Issue (ii): It was submitted that the foreign award is in conflict with the public policy of India, as expounded by SC in ***Renusagar Power Company Limited v. General Electric Company [1994 Supp (1) SCC 644],*** wherein it was held that public policy of India, in the context of foreign awards, would be: (a) fundamental policy of Indian law; (b) the interests of India; and (c) justice or morality. It was submitted that there was an inherent character of national and public interest in the implementation of the PSC, and the natural gas was held in the sovereign trust of the people of India and that the petroleum produced would continue to remain with the nation, since the natural gas is a resource which is within the purview of Article 297 of the Constitution of India.

Contentions raised by the Respondents:

On Issue (i): The Respondents on the other hand, contended that they had a period of 12 years to seek enforcement of the award, specifically till 17.01.2023. They further contended that under Section 49 of the 1996 Act, the foreign award becomes a decree of an Indian court after the objections to the award are adjudicated by the enforcement court. Article 136 of the Limitation Act prescribes a period of 12 years from the date of the decree of the civil court, which would be the appropriate provision for execution of a foreign award. It was contended that if Article 137 of

the Limitation Act is held to be applicable for the enforcement of foreign awards, the limitation period would commence from "when the right to apply accrues", which does not necessarily mean the date of the award. It was further contended that the period of limitation would commence from the date when the award attained finality at the seat of arbitration.

It was also submitted that there was uncertainty in the law, as the Madras High Court had held limitation for enforcement of a foreign award to be 12 years, while the Bombay High Court treated this as 3 years, and hence, there was sufficient ground to condone the delay.

On Issue (ii): It was contended that the tribunal had correctly interpreted Article 15.5(c)(xi) of the PSC to hold that it was not an undertaking given by the Respondents to drill 21 wells, even though only 14 were required. It was submitted that the issue of interpretation of the PSC, and a review of the merits of the award, could not be raised under Section 48 of the 1996 Act. It was submitted that the Appellants cannot invite the court to take a "second look" at the award by seeking a review on merits. Reliance was placed on Explanation 2 of Section 48(2) of the 1996 Act, which clarifies that "the test as to whether there is a contravention with the fundamental policy of Indian law, shall not entail a review on the merits of the dispute".

It was submitted that the court at the seat of arbitration would have exclusive jurisdiction to annul or set aside a foreign award. The seat court, while deciding the public policy challenge, would decide the same in accordance with its own domestic public policy. Even though the substantive law of the contract was Indian law, it would not be applicable for deciding the challenge to the issue of excess of jurisdiction.

Observations of the Supreme Court

On Issue (i): The SC observed that there have been divergent views taken by High Courts with respect to the period of limitation for filing a petition for enforcement of a foreign award under the 1996 Act. Therefore, to condone the delay and settle the law on this issue, the court looked into a number of conflicting precedents. The SC observed that the intent of the legislature, to omit the reference to "foreign decrees" under Article 136 of the Limitation Act, was to confine Article 136 to the decrees of a civil court in India. The application for execution of a foreign decree would be an application not covered under any other article of the Limitation Act, and accordingly, would be covered by Article 137 of the Limitation Act.

The SC observed that the issue of limitation for enforcement of foreign awards, being procedural in nature, is subject to the *lex fori,* that is, the law of the forum (State) where the foreign award is sought to be enforced. Section 36 of the 1996 Act creates a statutory fiction for the limited purpose of enforcement of a 'domestic award' as a decree of the court, even though it is otherwise an award in an arbitral proceeding. It was observed that the arbitral tribunal cannot be considered to be a 'court', and the arbitral proceedings are not civil proceedings. The deeming fiction is restricted to treat the award as a decree of the court for the purposes of execution, even though it is, as a matter of fact, only an award in an arbitral proceeding. A legal fiction is to be limited to the purpose for which it was created, and it would not be legitimate to travel beyond the scope of that purpose, and read into the

provision. By a legal fiction, Section 49 of the 1996 Act provides that a foreign award, after it is granted recognition and enforcement under Section 48 of the 1996 Act, would be deemed to be a decree of "that Court" for the limited purpose of enforcement.

Article 136 of the Limitation Act would not be applicable for the enforcement / execution of a foreign award, since it is not a decree of a civil court in India.

With respect to condonation of delay, the SC observed that, the bar contained in Section 5 of the Limitation Act, which excludes an application filed under any of the provisions of Order XXI of the Code of Civil Procedure, 1908, would not be applicable to a substantive petition filed under Sections 47 and 49 of the 1996 Act, and, accordingly, an application under Section 5 of the Limitation Act for condonation of delay can be filed in the instant case. Keeping in view the facts of the present case, the SC observed that the petition for enforcement of the foreign award was filed within the period of limitation prescribed by Article 137 of the Limitation Act, and in any event, there are also sufficient grounds to condone the delay, if any, in filing the enforcement / execution petition under Sections 47 and 49 of the 1996 Act, on account of lack of clarity with respect to the period of limitation for enforcement of a foreign award.

On Issue (ii): The SC observed that the enforcement court cannot set aside a foreign award, even if the conditions under Section 48 of the 1996 Act are made out. The power to set aside a foreign award vests only with the court at the seat of arbitration, since the supervisory or primary jurisdiction is exercised by the curial courts at the seat of arbitration. The interpretation of the terms of the PSC lies within the domain of the tribunal. It was not open for the Appellant to impeach the award on merits before the enforcement court. The enforcement court may "refuse" enforcement of a foreign award, if the conditions contained in Section 48 of the 1996 Act are made out. The courts before which the foreign award is brought for recognition and enforcement would exercise "secondary" or "enforcement" jurisdiction over the award, to determine the recognition and enforceability of the award in that jurisdiction.

It was held that the enforcement court is not to correct the errors in the award under Section 48 of the 1996 Act, or undertake a review on the merits of the award, but is conferred with the limited power to "refuse" enforcement, if the grounds are made out.

It is pertinent to note that, with respect to the submission of the Respondents that the amended Section 48 of the 1996 Act would be applicable to the present case; or alternately, that the amendments effected in Section 48 of the 1996 Act would have retrospective effect, the SC observed that the amendment to Section 48 of the 1996 Act had introduced for the first time, a specific criteria, which states that, the test as to whether there is a contravention with the fundamental policy of Indian law, shall not entail a review on the merits of the dispute. Accordingly, it must be considered to be prospective, irrespective of the usage of the phrase "for the removal of doubts". Hence, the amendments to Section 48 of the 1996 Act were not applicable in the instant case.

Lastly, while considering the issue whether the award was in conflict with the public policy of India, and contrary to the basic notions of justice, the SC referred to various precedents to highlight the well-settled position in law with respect to the finality of awards in international commercial arbitrations, and the limits of judicial intervention on the grounds of public policy of the enforcement State. The SC observed that the Appellant firstly, had not established a case of violation of procedural due process in the conduct of the arbitral proceedings and secondly, the Appellant had not proved as to how the award is in conflict with the basic notions of justice, or in violation of the substantive public policy of India.

Decision of the Supreme Court

The SC held that the period of limitation for filing a petition for enforcement of a foreign award under Sections 47 and 49 of the 1996 Act, would be governed by Article 137and not Article 136 of the Limitation Act. Accordingly, it will be three years from when the right to apply accrues.

Further, the Malaysian Courts being the seat courts were justified in applying the Malaysian Act to the public policy challenge raised by the Government of India. The enforcement court would not review the correctness of the judgment of the seat courts, while deciding the challenge to the award. The enforcement court exercising jurisdiction under Section 48, cannot refuse enforcement by taking a different interpretation of the terms of the contract. Section 48 of the 1996 Act does not provide a de facto appeal on the merits of the award. However, if the award was found to be violative of the public policy of India, it would not be enforced by the Indian courts. The SC concluded that the award was not contrary to the fundamental policy of Indian law, or in conflict with the notions of justice, as discussed hereinabove. Accordingly, the award dated 18.01.2011 passed by the tribunal was held to be enforceable in accordance with the provisions of Sections 47 and 49 of the 1996 Act and the civil appeal was dismissed.

VA View

The judgement has put to rest the conflict regarding applicability of Article 136 or Article 137 of the Limitation Act in case of a petition for enforcement of a foreign award. The SC has clarified that foreign awards fall within the residuary provision, that is, under Article 137 of the Limitation Act. Therefore, the court has prescribed a definite period of 3 years from the time the "right to apply accrues."

The SC has also captured the fundamental essence of arbitration, that is, party autonomy, wherein the parties may decide the governing laws and have the freedom to submit to the curial laws of their choice. The SC has laid straight the legal matrix for the application of the governing law that determines the substantive rights and obligations of the parties in the underlying commercial contract, and the curial law of the arbitration is determined by the seat of arbitration, as in the instant case, the laws of Malaysia. The SC has reiterated even more firmly that the secondary court which are the enforcement courts in India, do not have the jurisdiction to delve into the questions of law, merits or jurisprudence of the basis of the foreign award. Their primary role is only to adhere squarely to the provisions of Section 48 of the 1996 Act. By passing this judgement, the SC has furnished much-awaited clarity on multiple issues as regards the enforceability of foreign awards.

III. Calcutta HC: NCLT order mandating filing record of default from the Information Utility to prove financial debt by the financial creditors struck down

The High Court of Calcutta (**"HC"**) has in its combined judgment dated August 18, 2020 (**"Judgment"**) in the matter of ***Univalue Projects Private Limited v. Union of India [W. P. No. 5595 (W) of 2020]*** and ***Cygnus Investments and Finance Private Limited & Another v. Union of India and Others [W.P. No. 5861 (W) of 2020],*** held that financial creditors can rely on either of the modes of evidences at hand to showcase a financial debt, that is, either a record of default from the Information Utility (**"IU"**) or any other documents as specified in the Insolvency and Bankruptcy Code, 2016 (**"IBC"**) to prove the existence of a financial debt.

Facts

The writ petitions had been filed by the petitioners under Article 226 of the Constitution of India against an impugned order dated May 12, 2020 issued by the Registrar of the National Company Law Tribunal (**"NCLT"**) at its principal bench in New Delhi, that *prima facie* appeared to have been issued with the approval of the Hon'ble Acting President of the NCLT, New Delhi. The said order imposed a mandatory prescription on all financial creditors, as defined under the provisions of the IBC, to submit certain financial information as a record of default before the IU, as a condition precedent for filing any new application as well as retrospectively on all those financial creditors who have pre-existing applications filed under Section 7 of the IBC, and pending before various benches of the NCLT, prior to such final hearing of these applications.

The first writ petitioner who had a pre-existing application filed under Section 7 of the IBC pending before the NCLT at its Kolkata Bench, argued that the impugned order has altered their substantive rights. It was also urged that the order has been issued *de hors* the parent act that establishes the NCLT, that is, the Companies Act, 2013 (**"CA"**), other relevant provisions of the IBC and as well as in contravention of regulations issued by the Insolvency and Bankruptcy Board of India (**"IBBI"**).

The learned counsel for the second writ petitioner urged that the petitioner, Cygnus Investments and Finance Private Limited, wanted to file a new application under Section 7 of the IBC to initiate a corporate insolvency resolution process against the targeted corporate debtor, but was restricted to do so due to the impugned order that required a filing of such an application to be appended with the record of default from an IU. The Hon'ble judge heard both the petitioners jointly and decided to pass a common judgement.

Issues

(i) What is the scope of the NCLT and whether the impugned order is *de hors* the IBC and the rules and regulations framed thereunder?

(ii) If the answer of the above is in negative, whether the NCLT could enforce the same retrospectively?

Arguments

Contentions raised by the petitioners:

The counsel for the first writ petitioner, referred to Section 424 of the CA and stated that the functioning of the NCLT and the National Company Law Appellate Tribunal (**"NCLAT"**), though not bound by the Code of Civil Procedure, 1908, still has to be guided by the principles of natural justice and is subject to the provisions of both the CA and the IBC and the rules and regulations established thereunder. Therefore, it has no power to alter the provisions of the CA or the IBC or the regulations framed thereunder. It was further argued that, on a comprehensive reading of Section 214 and Section 215 read with Section 240 of the IBC and Regulation 20(1) of the IBBI (Information Utilities) Regulations, 2017, it is clear that Section 215(2)of the IBC becomes imperative in the case of class of financial creditors who have a 'security interest' with respect to the financial debt as against the unsecured class of creditors, as the petitioners, who do not have such a security interest.

The learned counsel relied on the judgment of the Supreme Court in ***Hitendra Vishnu Thakur v. The State of Maharashtra [(1994) 4 SCC 602]*** to point out that the procedural statute should not be applied retrospectively where it will result into creation of new disabilities or obligations.

The learned counsel of the petitioner contended that the continuous usage of word 'or' in the Section 7(3)(a) of the IBC implies and indicates that the intention of the legislature was to make this section disjunctive. Stress was laid on the fact that a record of default recorded with the IU is one of the designated methods to prove the existence of a financial debt that has accrued to a financial creditor. It was contended that the intention of the legislature must be found in the words used by the legislature itself in their plain grammatical meaning. The learned counsel also relied upon Regulation 8 of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (**"CIRP Regulations"**) to highlight that Sub Regulation (2) of Regulation 8 enlists four other categories of documents in addition to the filing of records of default with IU, that may be submitted to prove the claims of creditors. Further, precedents of the NCLAT in ***Neelkanth Township and Construction Private Limited v. Urban Infrastructure Trustees Limited [Company Appeal (AT) (Insolvency) No. 44 of 2017 dated August 11, 2017]*** and ***Bharti Defence and Infrastructure Limited v. Edelweiss Asset Reconstruction Company Limited [Company Appeal (AT) (Insolvency) No. 71 of 2017 dated October 17, 2017]*** were referred, in which it was held that submitting the financial information before the IU cannot be a mandatory provision or sole criteria to prove the existence of a default in relation to financial debt.

The learned counsel appearing for the petitioners in the second writ petition, cited the dictum of ***General Officer Commanding – in – Chief v. Subhash Chandra Yadav [AIR 1988 SC 876]*** and stated that, two conditions must be fulfilled for a subordinate rule to have the effect of the statutory provision: (a) such rules must conform to the provisions of the statute under which it is framed, and (b) it must also be within the scope and purview of the rule making power of the authority framing the rule. Reference was made to the scope of Section 424 of the CA to infer that neither the Hon'ble Acting President of the NCLT, New Delhi nor the Registrar of the NCLT have the power of

rule-making. The learned counsel also relied on the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016 (**"AA Rules"**), specifically Rule 4(1) of the AA Rules, that deals with the application filed by financial creditor. According to the said rule, other documents, records and evidences can be filed alongside the Form-1 to prove an existing default.

An interesting submission was made by the learned counsel that NCLT was also not empowered by the inherent powers under Rule 11 of the National Company Law Tribunal Rules, 2016 to promulgate the impugned order. Reliance was placed on ***Tata Chemicals Limited v. Kshitish Bardhan Chunilal Nath [AIR 2019 Cal 353]*** to submit that the scope of inherent powers cannot be exercised such that it is in conflict with the statute or against legislative intent.

Contentions raised by the respondents:

The learned counsel for the respondent argued that both the NCLT and NCLAT can regulate their own procedures as per Section 424 of the CA and hence, were well within their rights to issue the impugned order. It was further stated that the Section 215(2) of the IBC does not make any distinction between a secured creditor and an unsecured creditor. It was further submitted that in both the situations, that is, submission of financial information, and, information relating to assets in relation to which security interest has been created, in such form as prescribed by the regulations, a financial creditor has to file such information with the IU mandatorily, irrespective of being a secured or an unsecured creditor. The learned counsel then relies on the Supreme Court judgement of ***Izhar Ahmad Khan v. Union of India [AIR 1962, SC 1052]*** to submit that there are two categories of law, substantive and procedural law, wherein evidence is a part of procedural law. Hence, it is the power of the tribunal to regulate its own procedure within the Section 424 of the CA. He further argued that no new disabilities have been created by the impugned order since the Section 7(3)(a) of the IBC states mandatorily that the financial creditor shall furnish the application and record of default with the IU.

Observations of the High Court of Calcutta

Multiple precedents were referred and it was observed that while both the NCLT and NCLAT have been conferred with powers to regulate their own procedure, such use of its power is circumscribed and subject to, *inter alia,* the principles of natural justice as well as the provisions of the CA or the IBC, inclusive of any rules/regulations framed under such legislations. In ***Government of Andhra Pradesh v. P. Laxmi Devi (Smt) [(2008) 4 SCC 720]*** the SC had captured the hierarchy of the legal norms in India based on the jurist Kelsen's 'Pure Theory of Law'. Therefore, it was inferred that the Acts passed by the Parliament preceded over the Rules enacted by the Government or the Regulatory Board and at the bottom of the pyramid lay adjudicating authority regulating their own procedures.

The phrase 'as may be specified' under Section 7(3)(a) of the IBC, read with the definition of the term "specified" under Section 3(32) of the IBC were referred, to conclude that the positive conditions separated by "or" are read in the alternative and that there are three categories of evidence that can be provided. It was observed, while referring to various provisions, including Section 7 of the IBC read with Rule 4 of the AA Rules, Form-1 therein,

Regulation 8 of the CIRP Regulations and precedents, that apart from the financial information of the IU, eight classes of documents can be considered to be sources that evidence a "financial debt".

Decision of the High Court of Calcutta

The Hon'ble HC of Calcutta held that IU was only one of the designated methods of furnishing proof to the NCLT, to prove the existence of a financial debt that has accrued to a financial creditor. The Hon'ble Bench observed that the impugned order is a "prickly thorn" which is against the principle of natural justice and that it adversely affected the substantive rights of the petitioners as financial creditors envisaged under the IBC. The bench held that the order did not qualify the tests laid down in the judgement of ***General Officer Commanding – in – Chief v. Subhash Chandra Yadav [AIR 1988 SC 876].*** The Bench further held that the retrospective nature of the order does create new disabilities for the financial creditors and was bad in law. The NCLT acted without jurisdiction and exceeded beyond its limit of the four corners of Section 424 of the CA, and was in violation of Section 7(3)(a) of the IBC and rules and regulations framed thereunder. Hence, the impugned order is *de hors* the CA, the IBC, and rules and regulations framed thereunder.

The HC was of the view that the financial creditors can rely on either a record of the default from the IU or any other document as specified to showcase a financial debt. Therefore, it can be inferred that Section 215 of the IBC is not mandatory in nature. It is also clarified that any delegatee under the IBC and the CA, that is, the Central Government, the IBBI and the NCLT, cannot make any retrospective regulations. Hence, the impugned order dated May 12, 2020 issued by the principal bench of the NCLT, New Delhi was held to be ultra vires the IBC and the regulations thereunder, and was accordingly struck down.

VA View:

This judgement clarified an important area of law, pursuant to the order dated May 12, 2020 issued by the principal bench of the NCLT, New Delhi. The HC highlighted the hierarchy of legal norms in India and reiterated the well-established principle that a delegated or subordinate legislation cannot be retrospective in nature, unless the rule-making authority has been vested with power under a statute to make rules with retrospective effect. The HC has vividly looked at the nature of the transactions that the IBC governs, the dynamics of which cannot be restricted by imposing rules/regulations in retrospect. The financial creditors play a major role in the society and therefore, in lines with the object of the IBC, the judgement has protected the interests of all the stakeholders. The HC, by making filings of record of default with the IU only directory in nature, has further prescribed that the procedural aspects of law cannot ride over the substance and the object of the law. The procedures are only meant to promote the interest of the beneficiaries. Even though IUs are, in principle, a positive change, the HC has worked to ensure that no person shall be negatively affected due to the non-filing of past debts with the IU. In due course of time, IUs shall be the norm, however, for now, the HC has rightly ensured that it is not mandatory in nature.

IV. Supreme Court: A personal loan to a promoter or a director of a company cannot trigger the CIRP under the IBC

The Supreme Court (**"SC"**) by its judgement dated August 28, 2020 (**"Judgment"**) in the case of ***M/S Radha Exports (India) Private Limited v. K.P. Jayaram & Another [Civil Appeal No. 7474 of 2019]*** held that a personal loan to a promoter or director of a company cannot trigger the Corporate Insolvency Resolution Process (**"CIRP"**).

Facts

M/s Radha Exports (India) Private Limited (**"Appellant Company"**) filed an appeal under Section 62 of the Insolvency and Bankruptcy Code, 2016 (**"IBC"**), against an order of the National Company Law Appellate Tribunal (**"NCLAT"**). The brief background of the case is that, the National Company Law Tribunal (**"NCLT"**) had passed an order dated December 19, 2018 rejecting the application filed by Mr. K.P. Jayaram (**"Respondent No. 1"**) and Mrs. Shoba Jayaram (**"Respondent No. 2"**), (collectively **"the Respondents"**) under Section 7 of the IBC, *inter alia,* on the grounds that they were not financial creditors of the Appellant Company, and in any case the alleged claim of the Respondents was barred by limitation. Being aggrieved by the order of the NCLT, the Respondents preferred an appeal at the NCLAT. The NCLAT by a judgment and order dated September 02, 2019 allowed the appeal against the order passed by NCLT. Thereafter, being aggrieved by the order passed by the NCLAT, the Appellant Company filed this appeal at the Hon'ble Supreme Court.

The Appellant Company contended that the Respondents were closely acquainted with one Mr. M. Krishnan, and Mrs. Radha Gouri, who were the promoters of the Appellant Company. The Respondents had advanced an aggregated loan of INR 2.20 crores (unsecured and free of interest), to M/S Radha Exports, a proprietorship concern of Mrs. Radha Gouri, during the period between 2002 and 2004. Thereafter, the Appellant Company was incorporated under the Companies Act, 1956 on or about July 19, 2004, to take over the business of the proprietorship concern, M/s Radha Exports, along with its assets and liabilities. The Appellant Company stated that as on July 19, 2004, the proprietorship concern, M/s Radha Exports, had a loan liability of INR 1,11,85,350/-, which was taken over by the Appellant Company.

The Respondents requested the Appellant Company to convert a sum of INR 90,00,000/- from out of the said outstanding loan, as share application money for issuance of shares in the Appellant Company, in the name of the Respondent No. 2, and the same was confirmed by the Respondents, by their letter dated January 11, 2011, addressed to the Deputy Commissioner of Income Tax, Company Circle V(3), Chennai. Accordingly, a sum of INR 90,00,000/- was adjusted by the Appellant Company, as share application money, for issuance of shares of the Appellant Company in the name of the Respondent No. 2. Subsequently, the loan was repaid in full by the year 2006.

In October 2007, the Respondent No. 2 resigned from the Board of the Appellant Company. At the time of resignation, the Respondent No .2 requested the Appellant Company to treat the share application money of INR 90,00,000/- as share application money of Mr. M Krishnan and to issue shares of the value of INR 90,00,000/- in the name of Mr. M. Krishnan. The amount of share application money of INR 90,00,000/- transferred to Mr. M. Krishnan, was to be treated as a personal loan from the Respondent No. 2 to the said Mr. M. Krishnan.

Thereafter, by a legal notice dated November 19, 2012, the Respondents called upon the Appellant Company to repay to the Respondents a sum of INR 1,49,60,000/- alleged to be the outstanding debt of the Appellant Company, repayable to the Respondents as on July 19, 2004. By a letter dated December 05, 2012, the Appellant Company refuted the claim of the Respondents, whereupon the Respondents filed a petition in the High Court of Madras under Sections 433 (e) & (f) and 434 of the Companies Act 1956, for winding up of the Appellant Company. The said petition was transferred to the Chennai Bench of NCLT for adjudication. Thereafter, by an order dated August 04, 2017, the NCLT dismissed the said winding up petition, on the ground that the Respondents had failed to comply with the provisions of Section 7(3)(b) of the IBC. However, the order allowed the Respondents the liberty to withdraw the petition. Meanwhile the Respondents withdrew the said petition and consequently, on December 07, 2017, issued a fresh "demand notice" to the Appellant Company which was refuted by a letter dated December 14, 2017 by the Appellant Company, *inter alia,* claiming that all amounts due and payable by the Appellant Company or its predecessor-in-interest to the Respondents, had duly been paid within 2007 and 2008. The Respondents, thereafter, filed a petition under Section 9 of the IBC, as an operational creditor of the Appellant Company. However, the Respondents withdrew this case and filed a fresh petition under Section 7 of the IBC claiming principal amount of INR 2.10 Crores along with interest at the rate of 24% per annum from 2007, amounting to INR 4,41,60,000/-

Issues

Maintainability of the CIRP under Section 7 of the IBC initiated against the Appellant Company.

Observations of the Supreme Court

The SC observed that the NCLAT was not inclined to accept the submission of the Appellant Company, that the entire amount had been paid, for two purported reasons. The first reason was that the Correlation Statement showed payments of certain amounts amounting to INR 53,05,000/- in favour of Customs, Chennai and payments amounting to INR 1,75,000/- in favour of one Mr. Kulasekaran. The Respondents, as financial creditors, had disputed that these payments were towards the dues of the financial creditors. The second reason was that, if the total amount had been paid, there was no reason for the Appellant Company to take the plea that the amount was not payable, the same being barred by limitation.

In response to the second reasoning, the SC observed that it is well settled in law that alternative defences are permissible to contest a claim. It was thus open to the Appellant Company, to refute the claim of the Respondents by taking the plea of limitation and also to contend that no amount was in fact due and payable by the Appellant Company to the Respondents. The Court relied on ***Innoventive Industries Limited v. ICICI Bank and Another [(2018) 1 SCC 407]*** and ***B.K. Educational Services Private Limited v. Parag Gupta and Associates [(2019) 11 SCC 633]*** to hold that even otherwise, it was for the applicant invoking CIRP, to *prima facie* show the existence in his favour, of a legally recoverable debt, and once a debt, or even part thereof, becomes due and payable, the limitation period for resolution process begins. In other words, the Respondents had to show that the debt is not barred by limitation, which they failed to do.

The SC went on to observe that basis the letter signed by the Respondents, the Respondent No. 2 resigned from the Board of the Appellant Company and at that time the Respondent No. 2 requested the Appellant Company to

treat the share application money of INR 90,00,000/- as share application money of Mr. M. Krishnan and to issue shares for aforesaid value to Mr. M. Krishnan. The amount was to be treated as a personal loan from the Respondent No. 2 to Mr. M. Krishnan, in essence, a personal loan to a promoter or a director of a company. Hence the same cannot trigger the CIRP under the IBC.

The SC importantly also observed the limited scope of proceedings/disputes that the NCLT may entertain to resolve under Section 7 of the IBC. The SC stated that the disputes as to whether the signatures of the Respondents are forged or whether records have been fabricated, can be adjudicated upon evidence including forensic evidence in a regular suit.

The SC further observed that the payment received for shares, duly issued to a third party at the request of the payee, as evident from official records, cannot be a debt, not to speak of financial debt.

Decision of the Supreme Court

In view of the above, SC held that personal loan to a promoter or a director of a company cannot trigger CIRP under the IBC.

VA View

This judgement of the SC will herald a much-needed clarity on the nature of transactions within a company that can be included as "debt" under IBC. It has been made clear by the SC that the payment received for shares, duly issued to a third party at the request of the payee cannot be a debt at all under the IBC.

Thus, this judgement clears the air on complex transactions between promoters and directors in their individual capacity, absolving the company from any liability that can be construed as debt under IBC. This judgement therefore prevents the misuse of the IBC, for purposes of initiating CIRP for the recovery of money.

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