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Key Highlights

I. Supreme Court: Interest free term loans advanced to a corporate person are not excluded from the purview of a financial debt under Section 5(8) of the Insolvency and Bankruptcy Code, 2016.

II. Bombay High Court: A secured debt shall take priority over the 'Government' dues/tax dues under the SARFAESI Act.

III. NCLAT: Rejects application filed under Section 7 of the Insolvency and Bankruptcy Code, 2016 on grounds of collusion between the corporate debtor and the financial creditor.

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I. Supreme Court: Interest free term loans advanced to a corporate person are not excluded from the purview of a financial debt under Section 5(8) of the Insolvency and Bankruptcy Code, 2016

The Hon'ble Supreme Court ("**SC**") has in its judgment dated July 26, 2021, in the matter of ***Orator Marketing Private Limited v. Samtex Desinz Private Limited [Civil Appeal No. 2231 of 2021]*** ("**Judgement**") held that the definition of financial debt under Section 5(8) of the Insolvency and Bankruptcy Code, 2016 ("**IBC**") does not exclude an interest free loan and that it would have to be construed to include interest free loans advanced to finance the business operations of a corporate body.

Facts

M/s Sameer Sales Private Limited ("**Original Lender**"), advanced a term loan of INR 1.60 crores to M/s Samtex Desinz Private Limited ("**Corporate Debtor**") for a period of two years in order to enable the Corporate Debtor to meet its working capital requirements. Thereafter, the Original Lender assigned the outstanding loan to M/s Orator Marketing Private Limited ("**Appellant**"). As per the loan agreement, the loan was due and payable on February 1, 2020. According to the Appellant, the Corporate Debtor made some payments, however, INR 1.56 crores remained outstanding.

The Appellant filed an application under Section 7 of the IBC before the National Company Law Tribunal, New Delhi ("**NCLT**") seeking the initiation of the Corporate Insolvency Resolution Process ("**CIRP**") against the Corporate Debtor. The NCLT rejected the application of the Appellant on the ground that the Appellant had extended an interest free loan and had failed to prove that the loan was disbursed against consideration of time value of money. Thereafter, the National Company Law Appellate Tribunal, New Delhi ("**NCLAT**"), upheld the order of the NCLT on the aforementioned ground that since the money borrowed is not against payment of interest, it could not be termed as a financial debt under Section 5(8) of the IBC.

Being aggrieved by the order of the NCLAT, the Appellant filed the present appeal before the SC under Section 62 of the IBC.

Issue

Whether a person who extends a term loan to a corporate person free of interest, for its working capital requirements is not a financial creditor and therefore, incompetent to initiate CIRP under Section 7 of the IBC.

Arguments

Contentions raised by Appellant:

It was the submission of the Appellant that since even after a period of two years, the loan still remained due, it must be thereafter treated as a financial debt. The Appellant relied on the judgment of the NCLAT in the matter of ***Mack Soft Tech Private Limited v. Quinn Logistics India Limited [Company Appeal (AT) (Ins) No.143 of 2017]***, to submit that when there is disbursement and default, it should be construed as a financial debt. It was further contended that after the

execution of the assignment agreement in its favour, the Appellant, not being a related party and having taken the assignment for consideration, the loan extended would be a financial debt.

Observations of the Supreme Court

The SC observed that the definition of financial debt under Section 5(8) of the IBC was misconstrued by both the NCLAT and the NCLT by reading the same in isolation and out of context and hence the judgment and order of the NCLAT affirming the order of the NCLT was patently flawed.

It was further noted that, in a plethora of judgments, it has been observed that while construing and/or interpreting any statutory provision, the legislative intent of the statute must be looked at and that each word, phrase or sentence has to be construed in light of the general purpose of the act itself. Therefore, when the meaning of a certain provision in a statute is to be construed, the statue has to be read as a whole; the previous state of the law, the general scope and ambit of the statute and the mischief that it was intended to remedy, would all be relevant factors.

The SC relied on its judgment in ***Pioneer Urban Land and Infrastructure Limited v. Union of India [4 (2019) 8 SCC 416],*** where numerous previous judgments including ***Innoventive Industries Limited v. ICICI Bank Limited [2 (2018) 1 SCC 407]*** and ***Swiss Ribbons Private Limited and Another v. Union of India and Others [3 (2019) 4 SCC 17]*** were referred to and held that even individuals who were debenture holders could be financial creditors who could initiate CIRP.

The SC further observed that the definition of financial debt under Section 5(8) of the IBC cannot be read in isolation, without considering other relevant definitions, particularly, the definition of 'claim' in Section 3(6), 'corporate debtor' in Section 3(8), 'creditor' in Section 3(10), 'debt' in Section 3(11), 'default' in Section 3(12) and 'financial creditor' in Section 5(7) along with Sections 6 and 7 of the IBC. In order to arrive at its decision, the SC relied on the definition of financial debt in Section 5(8) of the IBC which provides that "*a debt along with interest if any which is disbursed against the consideration of the time value of money and includes money borrowed against the payment of interest, as per Section 5 (8) (a) of the IBC*" and observed that the NCLT and the NCLAT have overlooked the words "*if any*" which could not have been intended to be otiose. 'Financial debt' would mean outstanding principal due in respect of a loan and would also include interest thereon, if any . In the event that there is no interest payable on the loan, only the outstanding principal would qualify as a financial debt. Therefore, both the NCLAT and the NCLT failed to notice Clause (f) of Section 5(8) of the IBC, in terms whereof a financial debt includes any amount raised under any other transaction, having the commercial effect of borrowing.

Additionally, it was observed that sub-clauses (a) to (i) of Section 5(8) of the IBC are illustrative and not exhaustive. It was noted that the legislature has the power to define a word in a statute and that such definition may be restrictive or extensive but when the word is defined to include something, then such definition is *prima facie* extensive. While making the aforesaid observation, the SC referred to its judgment in ***State of Bombay v. Hospital Mazdoor Sabha and Others [6 AIR 1960 SC 610],*** wherein it was held that *"It is obvious that the words used in an inclusive definition denote extension and cannot be treated as restricted. Where we are dealing with an inclusive interpretation, it would be inappropriate to put a restrictive interpretation upon words of wider denotation."*

Lastly, the SC noted that, taking into account the aims, objectives and scheme of the IBC, there is no discernible reason as to why a term loan to meet the financial requirements of the Corporate Debtor for its operation, which obviously has the commercial effect of borrowing, should be excluded from the purview of financial debt. It was further observed that the trigger for initiation of CIRP by a financial creditor under Section 7 of the IBC is the occurrence of default by the corporate debtor and default includes financial debt and operational debt. Further, the definition of debt is also expansive and it includes, *inter alia*, financial debt. Therefore, since, the definition of financial debt under Section 5(8) of the IBC does not exclude an interest free loan, it would have to be construed to include interest free loans advanced to finance the business operations of a corporate body.

Decision of the Supreme Court

In view of the above, the SC allowed the appeal and set aside the orders of the NCLT and the NCLAT which dismissed the petition of the Appellant under Section 7 of the IBC. It was also directed that the petition filed by the Appellant under Section 7 of the IBC before the NCLT would stand revived and is to be considered afresh in accordance with the law and findings in the present Judgement.

VA View:

Since the commencement of the IBC, it has been observed consistently that a debt would require the elements of 'debt along with interest' or 'time value of money' to qualify as a financial debt under Section 5(8) of the IBC. The SC observed that the orders of the NCLT and the NCLAT were patently flawed having misconstrued the definition of 'financial debt' by reading the definition in isolation and out of context. The SC further clarified that a term loan meeting the financial requirements of a Corporate Debtor for its operation has the commercial effect of borrowing, and hence should not be excluded from the purview of a financial debt.

The SC in this Judgement, giving regard to the aim, objective and scheme of the IBC has rightly clarified that clauses (a) to (i) of the said Section are not exhaustive and it is to be construed to include an interest free loan. The SC held that the definition of 'financial debt' cannot be read in isolation, without taking into consideration other relevant definitions of the IBC as the statute has to be read as a whole.

II. Bombay High Court: A secured debt shall take priority over the 'Government' dues/tax dues under the SARFAESI Act

The Bombay High Court ("**BHC**") has in its judgement dated July 28, 2021, in the matter of ***M/s Edelweiss Asset Reconstruction v. M/s Tax Recovery Officer, Income-Tax Department and Others [Writ Petition (L) No. 7964 OF 2021],*** held that, the secured debt shall take priority over the 'Government' dues/tax dues.

Facts

M/s Classic Diamonds (India) Limited ("**Borrower**"), a company under liquidation, was sanctioned facility/debt ("**Credit Facility**") by the State Bank of India ("**SBI**") and IndusInd Bank (collectively referred to as "**Lenders**") in 2003 and 2011 respectively. The Credit Facility was secured by way of an equitable mortgage created by way of deposit of title deeds in respect of various immovable properties including one office in Opera House, Mumbai ("**Premises**"). The Borrower defaulted in repayment of the Credit Facility. Consequently, the Lenders filed separate proceedings before the Debts Recovery Tribunals-II, Mumbai.

In the meanwhile, due to the non-payment of income tax dues by the Borrower, the Tax Recovery Officer, Income Tax Department ("**ITD**"), by its order dated January 17, 2013, levied attachment over the Premises prohibiting and restraining the Borrower from transferring or creating a charge on the Premises ("**Attachment Order**").

M/s Edelweiss Asset Reconstruction Company ("**EARC**") is a company registered as a securitization and asset reconstruction company pursuant to Section 3 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 ("**SARFAESI Act**"). EARC, by two deeds of assignment dated March 19, 2014 and March 29, 2017, acquired all the rights, title and interest with respect to the Credit Facility ("**Assignments**") granted by the Lenders to the Borrower. The Assignments were along with the benefits of security of equitable mortgages created by way of deposits of title deeds over the immovable properties of the Borrower including the Premises in favour of the banks. Thereafter, EARC, being the assignee, was substituted as the original applicant in two original applications filed by the Lenders because of the defaults committed by the Borrower in repayment of debts before the Debts Recovery Tribunals-II, Mumbai by orders dated November 17, 2014 and December 07, 2017, respectively.

On May 25, 2017, EARC called upon the Borrower to pay the balance of outstanding Credit Facility by initiation of proceedings under Section 13(*enforcement of security interest*) of the SARFAESI Act. However, on account of failure of repayment of debt, on November 08, 2017, EARC took possession of the Premises under Section 13(4) of the SARFAESI Act with an intention to sell the Premises. In December 2019, the EARC discovered that the ITD had prohibited the selling/transferring the Premises by virtue of the Attachment Order. Consequently, EARC repeatedly requested the ITD to vacate/lift the attachment on the Premises or grant a no objection certificate ("**NOC**") for the sale of the Premises. On account of no response by the ITD and aggrieved by the Attachment Order, EARC filed this writ petition under Article 226 of the Constitution of India before the BHC seeking order and direction for ITD to raise the said attachment levied on the Premises and to issue an NOC permitting EARC to sell the Premises.

Issue

Whether the secured debt assigned in favour of EARC has a priority over Government dues/tax dues.

Arguments

Contentions raised by EARC:

EARC, *inter alia*, contended that it is a secured creditor and as per the provisions of Section 26-E (*priority to secured creditors*) of the SARFAESI Act, it has prior and superior charge over the Premises which cannot be disturbed because of the dues of ITD. EARC argued that Section 26-E of the SARFAESI Act provides a statutory recognition of the priority of claim of secured creditor over all other debts and all taxes, cess and other rates payable to 'Central Government' or 'State Government' or any local authority. Therefore, under the provisions of the SARFAESI Act, EARC was empowered to sell the assets of the Borrower and recover its dues over and above the attachment levied by ITD by virtue of the Attachment Order.

It was further contended that, the priority of the charge of EARC over the dues of the ITD also stood clarified by virtue of the Enforcement of Security Interest and Recovery of Debt Laws and Miscellaneous Provisions (Amendment) Act, 2016 ("**SIRDLMP Amendment**"). Section 41 (*insertion of new section 31-B*) of the SIRDLMP Amendment introduced Section 31-B (*priority to secured creditors*) under the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 ("**RDDB Act**"). Section 31-B of the RDDB Act, similar to Section 26-E of the SARFAESI Act, provides a statutory recognition of the priority of claim of secured creditor over all other debts and all taxes, cess and other rates payable to Central Government or State Government or local authority.

EARC also relied upon the decision of the Hon'ble Supreme Court ("**SC**") in the case of ***Bombay Stock Exchange v. V. S. Kandalgaokar [(2015) 2 SCC 1]*** ("**BSE Case**") and the decision of the BHC in the case of ***State Bank of India v. State of Maharashtra [(2020) SCC online Bom 4190]*** ("**SBI Case**"). It was submitted that in both the abovementioned judicial pronouncements, it was held that the Income Tax Act, 1961 ("**IT Act**") does not provide for paramountcy of income tax dues. It was further submitted that in the SBI Case (supra), it was held that secured debt has priority over income tax dues and, therefore, EARC as secured creditor has a prior superior charge over the income tax dues.

Contentions raised by the ITD:

The ITD in an affidavit in reply dated July 09, 2021 submitted that, as the total 'Income Tax' demand against the Borrower was INR 58,64,54,659/-plus interest for different assessment years from 2006-2007 to 2013-2014, in the absence of any other means of recovery of the outstanding demand, the Premises of the Borrower was attached by virtue of the Attachment Order under the provisions of the IT Act.

The ITD submitted that during the recovery survey under Section 133A (*power of survey*) of the IT Act, the Borrower was summoned to produce various details including details of loans and advances, however, Borrower had nowhere mentioned about the mortgage over the Premises and, therefore, the Premises was attached. ITD also relied on the decision of the SC in the case of ***Central Bank of India v. State of Kerala [(2009) 4 SCC 94]*** **("CBI Case")** wherein it was held that, in case the statutory first charge is created in favour of State under Section 26B (*tax payable to be first charge on the property*) of the Kerala General Sales Tax Act, 1963 then, the said charge shall have primacy over the right of the bank to recover its dues.

Lastly, it was submitted that the Premises of the Borrower has been attached by the ITD in the interest of the ITD as per Sections 220 (*when tax payable and when assessee deemed in default*) to 232 (*recovery by suit or under other law not affected*) of the IT Act and Second Schedule (*procedure for recovery of tax*) thereof, and there is no provision in the IT Act to vacate/lift the attachment till the finalisation/recovery of the demand. Therefore, in the absence any such provision, the ITD itself cannot vacate/lift the attachment on the Premises pursuant to the Attachment Order and it would be for the BHC to pass appropriate orders.

Observations of the Bombay High Court

The BHC analysed the judicial pronouncement relied on by both the parties and observed that the SC in the BSE Case (supra), while considering the question whether the lien exercised by the stock exchange can be said to be a superior right to the income tax dues, held that the IT Act does not provide for any paramountcy of dues by way of income tax. The BHC further observed that the SC while giving the decision in the BSE Case (supra) also referred to its own decision in the case of ***Dena Bank v. Bhikhabhai Prabhudas Parekh & Co. [(2000) 5 SCC 694]***, where it was held that Government dues have priority only over unsecured debts. The BHC further assessed that in the SBI Case, the BHC also considered the question of priority between the charge of a secured creditor and tax/VAT dues under the Maharashtra Value Added Tax Act, 2002 and, after considering the provisions of SARFAESI Act as well as RDDB Act**,** it was observed that the mortgage of a secured creditor gets prior charge over the charge of the state for tax/VAT dues.

The BHC, with reference to the CBI Case (supra) relied on by the ITD, observed that the said decision was distinguished in the SBI Case (supra) wherein, the SC stated that, since Section 26E of the SARFAESI Act and Section 31- B of the RDDB Act were not in the statue book at the time of deciding the CBI Case (supra), the impact of the said sections did not come into consideration. In light of the abovementioned case laws and provisions, the BHC was of the view that EARC's charge/mortgage over the Premises has priority over the dues of the ITD.

Decision of the Bombay High Court

The BHC allowed the petition and arrived at the conclusion that the EARC's charge/mortgage on the Premises has priority over the dues of the ITD and directed the ITD to release the attachment levied pursuant to the Attachment Order on the Premises and issue a NOC permitting the EARC to sell the said premises.

VA View:

The BHC's order deals with the doctrine of priority of crown debt. The common law doctrine of priority of crown debt pertains to a common law principle that the debt due to the state or the king claims priority before all other creditors. The basic justification for the said principle rests on the well-recognized principle that the State is entitled to raise money by taxation because unless adequate revenue is received by the State, it would not be able to function as a sovereign government at all.

Over the years, the SC, through various judgements mentioned above, and others, has created an exception to this doctrine by stating that a debt which is secured takes priority over the Government dues/tax. The BHC's order rightly upholds what the SC has upheld in similar matters where the question of priority of secured debt over crown debt was raised.

III. NCLAT: Rejects application filed under Section 7 of the Insolvency and Bankruptcy Code, 2016 on grounds of collusion between the corporate debtor and the financial creditor

The National Company Law Appellate Tribunal, Principal Bench, New Delhi ("**NCLAT**") has in its judgment dated June 30, 2021 ("**Judgement**"), in the matter of ***Hytone Merchants Private Limited v. Satabadi Investment Consultants Private Limited [Company Appeal (AT) (Insolvency) No. 258 of 2021],*** relied on Section 65 of the Insolvency and Bankruptcy Code, 2016 ("**IBC**"), to hold that, an application can be rejected on grounds of it being filed collusively and with a malicious intent, that is, not with an intention of resolution of insolvency of the corporate debtor (irrespective of the application complying with all requirements of Section 7(5) of the IBC).

Facts

Hytone Merchants Private Limited ("**Appellant**") had given an unsecured loan of INR 3 lakhs to Satabadi Investment Consultants Private Limited, the corporate debtor ("**Respondent**") for a period of six months, on February 15, 2019. The Respondent had acknowledged receipt of the unsecured loan amount and also issued a demand promissory note. Subsequently, the Respondent defaulted to repay the dues. The Appellant had issued a demand notice dated October 16, 2019 recalling the unsecured loan, but the Respondent failed to clear the outstanding dues.

Thereafter, an application under Section 7 of the IBC ("**Application**") was filed by the Appellant to initiate corporate insolvency resolution process ("**CIRP**") against the Respondent. The Application was complete and met all requirements under the IBC and regulations thereunder. The existence of debt and default were admitted during the proceedings before the National Company Law Tribunal, Kolkata ("**NCLT**"). However, the NCLT rejected the Application by an order dated February 02, 2021, ("**Impugned Order**"). Accordingly, aggrieved by the Impugned Order, the instant appeal was filed by the Appellant before the NCLAT.

Issue

Whether the Application could be rejected by the NCLT, by relying on Section 65 of the IBC (irrespective of the Application complying with all requirements of Section 7(5) of the IBC), on grounds of it being filed collusively, and with a malicious intent, that is, not with an intention of resolution of insolvency.

Arguments

Contentions raised by the Appellants:

1. The NCLT overreached and exceeded its authority and jurisdiction

In the Impugned Order, it was observed that, the Application was complete in accordance with the law, and that the Respondent was in default of a debt which was due and payable. The default amount was more than the minimum threshold stipulated in Section 4(1) of the IBC. In the said circumstances, under Section 7(5) of the IBC, the NCLT had no further discretion to exercise and ought to have admitted the Application and consequently initiated the CIRP against the Respondent. However, the NCLT, instead of following the mandate of Section 7(5) of the IBC, proceeded with an unjustified and roving enquiry to hold that the Application was filed in collusion by the Appellant and the Respondent.

The NCLT has referred the master data and the financial statements for the year 2018-19 of the Respondent to come to the finding of collusion. However, neither the master data nor the financial statements of the Respondent, as referred in the Impugned Order, were part of the records submitted in the Application. Further, it was brought to notice that master data mentioned in the Application did not show the corporate guarantee amount as mentioned in paragraph 9 of the Impugned Order. Assuming that any such guarantee exists, the same was still a liability of the Respondent. The NCLT misdirected itself and ignored the materials on record, categorically showing the existence of default. Instead, the NCLT proceeded to refer to and rely on purported documents that were not on record to arrive at a finding of collusion without giving any opportunity to the Appellant to make submissions in this regard. Therefore, the NCLT had grossly exceeded its jurisdiction and authority.

2. No scope for discretion of the NCLT

The Impugned Order has been passed in contravention of law, that is, the provisions of the IBC and the regulations thereunder. There is no discretion vested on the NCLT to reject an Application under Section 7(5) of the IBC if the default has occurred and the Application is complete. The Appellant further contended that the Hon'ble Supreme Court ("**SC**") in the case of ***Innoventive Industries Limited v. ICICI Bank [(2018) 1 SCC 407]*** had held that, "*the moment the NCLT is satisfied that the default has occurred, the Application must be admitted unless it is incomplete*." However, in passing the Impugned Order, the NCLT acted in derogation of the settled principles of law and, therefore, the Impugned Order deserves to be set aside. Furthermore, there were no facts on record to warrant the exercise of discretion to reject the Application. It was highlighted that, Section 7(4) of the IBC was relevant since the same categorically provided that the NCLT was required to "*ascertain the existence of a default from the records of an information utility or on the basis of other evidence furnished by the Financial Creditor under Sub-section (3)".* This evidences the limited scope of an adjudication of the NCLT, that is, adjudication is to be made on the evidence disclosed and on record. The NCLT is not empowered to initiate a roving enquiry *dehors* the records.

3. Change in the financial position of the Respondent

Furthermore, the financial statements of the Respondent for the year ending March 31, 2019 were not relevant because the Application was filed in December 2019 (more than eight months after March 31, 2019). Further, the Impugned Order rejecting the Application was passed on February 2, 2021, almost two years after March 31, 2019, therefore, the NCLT had ignored the possibility that the financial position reflected on March 31, 2019 may have undergone change in the intervening two years. The Respondent in this appeal, in their affidavit in reply, disclosed its financial statement for the year 2018-19 and categorically stated that the financial condition of the Respondent had deteriorated since then. Significantly, the NCLT had failed to appreciate the meaning of the Respondent's submission (though recorded in para 7 of the Impugned Order), that it was unable to repay dues of Appellant due to "*economic recession and losses in its business*" and due to Respondent "*being a victim of circumstances*" and "*by reason of the duration of the business*".

The reason for the deterioration was that major portion of its investment was into companies that were under liquidation and CIRP (M/s Kohinoor Pulp and Paper Private Limited and M/S Kohinoor Paper and Newsprint Private Limited, respectively), the Respondent being an unsecured financial creditor therein, there was no chance of getting the said money back, and the amounts were reflected in the accounts as per the accounting standard since the same cannot be immediately written off. However, the net worth of the Respondent stood substantially eroded after March 31, 2019.

4. No collusion between the Appellant and the Respondent

The Appellant has no relation or connection with the Respondent. A finding of collusion cannot be the outcome of guesswork, as is in the Impugned Order, especially not without giving the Appellant an opportunity to make any submissions on such issue. Thus, the Impugned Order of rejection is in violation of natural justice. Without prejudice,

Section 65 of the IBC also cannot apply to the facts of the case, firstly because there is no connection between the parties, secondly, the Appellant has demonstrated the existence of default and that had been recognised by the NCLT. Consequently, the scheme of the IBC has been ignored by the NCLT. Thus, the conclusion drawn by the NCLT of collusion existing between them was unwarranted, unfounded and bereft of any basis.

Contentions raised by the Respondent:

Due to business losses and economic recession, the Respondent was not able to repay the loan. The Impugned Order that alleged of existing collusion, was vehemently disputed. The Respondent had made several other commitments and investments, and it was in no current position to repay the recalled amount.

As per the order dated April 4, 2021, necessary clarifications were sought regarding the balance-sheet with regards to its mention in the order of the NCLT, dated January 04, 2021, where it is mentioned that the net worth of the Respondent was INR 15,36,39,015 as per the financial statements of 2018-2019. The Respondent contended that in the present situation, when the NCLT passed the Impugned Order, the condition of the Respondent had starkly deteriorated, and the Respondent was not in a condition to repay the same. Additionally, the Respondent had made substantial investments in companies under liquidation and CIRP as was evident from the entries in the balance sheet. The Respondent being an unsecured financial creditor, there was no chance of getting said money. As per standard accounting practices, the Respondent was bound to show said receivable in its accounts and could not write it off.

Observations of NCLAT

1. Scope for discretion of the NCLT

The NCLT had observed that, undisputedly the Application met all the requirements and that the Respondent was in default of a debt due and payable and that the default amount was more than the minimum threshold stipulated in Section 4(1) of the IBC. The NCLAT noted that, Section 7(5)(a) of the IBC provided that, "*where the Adjudicating Authority is satisfied that a default has occurred and the Application under Sub-section (2) is complete, and there is no disciplinary proceedings pending against the proposed Resolution Professional, it may, by order, admit such Application*." The NCLAT observed that, the use of the phrase 'it may' in Section 7(5) of the IBC itself provided the scope of discretion exercised by the NCLT in rejecting the Application. The NCLAT noted that, Section 7(5)(a) of the IBC lays down parameters about general conditions to admit an application. However, in the given situation, it appeared that the Application was filed collusively, not with the purpose of insolvency resolution, but otherwise, then despite fulfilling all the conditions of Section 7(5) of the IBC, the NCLT could exercise its discretion in rejecting the Application relying on Section 65 of the IBC. The NCLAT noted that, the SC in the case of ***Swiss Ribbons Private Limited v. Union of India [(2019) 4 SCC 17]*** had observed that, "*What is also of relevance is that in order to protect the Corporate Debtor from being dragged into the Corporate Insolvency Resolution Process mala fide, the Code prescribes penalties.*" The NCLAT observed that, therefore, it was clear that even if the Application filed under Section 7 of the IBC met all the requirements, then also the NCLT could exercise discretion, to prevent and protect the Respondent from being dragged into CIRP *mala fide*. It was also noted that, Sections 65 and 75 of the IBC prescribed penalties.

2. Lifting of corporate veil

The NCLAT noted that, Section 65 of the IBC explicitly provided that if any person initiated the insolvency resolution process or liquidation proceedings fraudulently or with malicious intent for any purpose other than for resolution of insolvency or liquidation, as the case may be, the NCLT may impose a penalty. The NCLAT noted that the SC in ***Arcelor Mittal India Private Limited v. Satish Kumar Gupta and Others [Civil Appeal Nos.9402-9405 OF 2018]*** while interpreting Section 29A of the IBC, held that the corporate veil may be lifted when a statute itself contemplates lifting the veil, or improper conduct is intended to be prevented, or a taxing statute or beneficial statute is sought to be evaded or where associated companies are inextricably connected as to be, in reality, part of one concern.

The NCLAT further analysed the well-established doctrines such as doctrine of "*piercing the corporate veil*" which stands as an exception to the principle that the company is a "*separate legal entity*" and distinct from a shareholder with its own legal rights and obligations. It seems to disregard the separate personality of company and attribute the acts of the company to those who are allegedly in direct control of its operation. The concept of a corporate entity was evolved to encourage and promote trade and commerce but not to commit illegalities or to defraud people. Therefore, the NCLAT noted that, where the corporate character is employed for the purpose of committing illegality or for defrauding others, the courts would ignore the corporate character and will look at the reality behind the corporate veil so as to enable it to pass appropriate orders to do justice between the parties concerned.

The NCLAT observed that, the expression "acting jointly" in the opening sentence of Section 29-A of the IBC cannot be

confused with "joint venture agreements". All that is to be seen by the expression "acting jointly" is whether certain persons have got together and are acting "jointly" in the sense of acting together. If this is made out on the facts, no superadded element of "joint venture" as is understood in law is to be seen. The other important phrase is "in concert". The NCLAT noted that, under Section 3(37) of the IBC, words and expressions used but not defined in the Code but defined, *inter alia*, by the Securities Exchange Board of India Act, 1992, and the Companies Act, 2013, shall have the meanings respectively assigned to them under those acts. The NCLAT observed that, thus, it was clear that the SC in Arcelor Mittal (supra) while interpreting the statutory provision of Section 29 A of the IBC, had recognised the principle of lifting the corporate veil in matters relating to insolvency under the IBC. Therefore, Section 65 of the IBC provides for punishment for fraudulent or malicious initiation of proceedings. The NCLAT observed that, it does not mean that Section 65 of the IBC will not be applicable to prevent such fraudulent or malicious initiation of proceedings. When a statute makes a provision for punishment for any wrong, it also contains deemed power to prevent it. Therefore, it cannot be said that Section 65 of the IBC will be applicable only after initiation of the CIRP fraudulently or with malicious intent. Thus, NCLAT observed that even if the Application complied with all requirements of Section 7 of the IBC, it was filed collusively, not with the intention of resolution of insolvency but otherwise. Therefore, it was not mandatory for the NCLT to admit the Application so as to save the Respondent from being dragged into CIRP *mala fide*.

3. The collusion between the Appellant and the Respondent

The NCLAT noted that, in the instant case, the NCLT in the Impugned Order had observed that, "*on perusal of the master debt of the Corporate Debtor it is seen that the Corporate Debtor has given a corporate guarantee of ₹ 482,42,00,000. On further enquiry and perusal of the financial statements for the Financial Year 2018-19 of the Corporate Debtor, it has come to light that the networth of the Corporate Debtor is ₹ 15,36,39,015. It is hard to convince oneself that the Company having a networth of ₹ 15,36,39,015 is not able to make a payment of ₹ 3 lakhs. It appears that the petition at hand has been filed in collusion with the Corporate Debtor*."

The NCLAT noted that, in the circumstances, the NCLT decided that the Application was filed in collusion with the Respondent and thereby rejected the Application filed under Section 7 of the IBC. There was a plausible contention to form such an opinion of collusion with the financial creditor that a company with a net worth of INR 15,36,39,015 has already given a corporate guarantee worth INR 482,42,00,000, was unable to repay a loan of INR 3 lakhs only. The NCLAT noted that, the Respondent, in its reply, did not dispute that it has extended the corporate guarantee. Since the master data of the Respondent reflected that the Respondent was also a corporate guarantor and has extended the corporate guarantee of a considerable amount worth INR 482,42,00,000, therefore, such plausible contention cannot be ruled out that the Respondent colluded with the Appellant to escape its liability as a corporate guarantor.

Decision of the NCLAT

The NCLAT relied on Section 65 of the IBC, to hold that, an application can be rejected on grounds of it being filed collusively and with a malicious intent, that is, not with an intention of resolution of insolvency of the corporate debtor (irrespective of the application complying with all requirements of Section 7(5) of the IBC). Consequently, the NCLAT held that the appeal *sans* merit and dismissed it.

VA View:

Based on precedents, the NCLAT clarified that, the legislature, consciously has provided the NCLT with powers to exercise discretion and scope to enquire into the motive of the applicant before adjudicating on the application for initiation of CIRP against the corporate debtor, irrespective of the existence of debt and default and completeness of such an application, being in accordance with law. The NCLAT, through this Judgement, has rightly upheld the integral principles of the IBC, that is, value maximization of the assets of the corporate debtor, and insolvency resolution, unlike admission of an application with a mala fide intent/collusion.

The NCLAT reiterated that, before admitting any application, every precaution is necessary to be exercised so that the insolvency process is not misused for any purposes other than the resolution of insolvency of a corporate debtor. In other words, discretion must be used by the NCLT to prevent and protect a corporate debtor from being dragged into a *mala fide* corporate insolvency resolution process.

IV. Delhi High Court: Arbitral award is liable to be set aside when there is no proper notice of the tribunal's appointment or of the institution of arbitral proceedings

The Delhi High Court ("**DHC**") has in its judgement dated July 15, 2021 in the matter of ***Komal Narula v. DMI Finance Private Limited and Another [O.M.P. (COMM.) 166/2019 and IA Nos. 6024/2019 & 11657/2020]***, ("**Judgement**") laid down that an arbitral award is liable to be set aside when there is no proper notice of the tribunal's appointment or of the institution of arbitral proceedings.

Facts

The instant case is an appeal under Section 34 *(Application for setting aside arbitral award)* of the Arbitration and Conciliation Act, 1996 ("**1996 Act**") against an award passed by the arbitral tribunal comprising of a sole arbitrator ("**Award**"). The impugned Award was rendered in the context of disputes that had arisen between the parties in relation to a common loan agreement dated January 14, 2015 ("**Agreement**"). DMI Finance Private Limited ("**Respondent No. 1**") is registered as a non-banking finance company with the Reserve Bank of India and DMI Housing Finance Private Limited ("**Respondent No. 2**") is registered as a housing finance company with the National Housing Bank. Respondent No. 1 and Respondent No. 2 are collectively referred to as "**Respondents**". The Respondents are companies of the same group with a common management.

According to the Respondents, Ms. Komal Narula ("**Petitioner**"), Mr. Nitin Chawla, Mr. Harsh Chawla, Mr. Jitin Chawla and Chawla Iron Traders Private Limited ("**Borrower Company**") collectively referred to as "**Borrowers**") jointly approached them and requested for financial assistance of INR 1,65,00,000. The Respondents jointly agreed to grant two loans of a sum of INR 1,15,00,000 and INR 50,00,000 respectively (collectively referred to as "**Loan Facilities**"). The Loan Facilities were sanctioned by the Respondents by letters dated January 14, 2015, which were duly signed by the Borrowers in acceptance of the terms and conditions therein. Subsequently, the parties executed the Agreement, demand promissory note and an affidavit cum undertaking dated January 14, 2015,. In terms of the Agreement and the sanction letter dated January 14, 2015, the Borrowers were liable to pay a sum of INR 2,28,414 per month in 84 (eighty-four) equal monthly instalments (EMI) commencing from March 5, 2015 to Respondent No. 1, towards the repayment of loan, and INR 99,310 per month in 84 (eighty-four) EMI commencing from March 5, 2015 to Respondent No. 2, towards the repayment of loan. The Borrowers, however, failed to make the payments for the aforesaid EMIs regularly. The Respondents, by a letter dated July 16, 2015, recalled the Loan Facilities granted to the Borrowers, alleging that the sale deed documents submitted by the Borrowers were not genuine and, therefore, the Borrowers had "*knowingly and wilfully committed fraud and misrepresentation against the lenders*". Accordingly, Respondent No. 1 recalled the amount of INR 1,14,04,541 and Respondent No. 2 recalled the amount of INR 49,58,818 and demanded that the amounts be paid on or before July 23, 2015. However, the Borrowers did not respond to the said letter. Since disputes had arisen between the parties, the Respondents sent a letter dated January 15, 2016, invoking the arbitration clause in the Agreement.

Thereafter, notices dated February 1, 2016 were issued to the Borrowers and Respondents to be present before the arbitrator, but the Borrowers were not represented. The postal report indicated that the Borrowers had refused to accept the notice and the office of the Borrower Company was reported closed, because of which the arbitral tribunal once again issued a notice to the Borrowers, informing the Borrowers that on the further failure to be represented on the fixed date and time, the arbitrator would pass the appropriate order. Such notice was sent to the new address of the Borrowers as well as the old one, and was sent by e-mail too. On March 11, 2016, the Borrowers were represented before the arbitral tribunal by Mr. Gaurav Soni. The arbitral proceedings were thereafter adjourned to March 17, 2016, for which the Borrowers did not appear. By an order dated March 17, 2016, the arbitral tribunal issued a formal notice to the Borrowers and restrained them from creating any third-party interest or alienating, transferring, selling or handing over the possession of the mortgaged property to any third party. The arbitral record indicated that the Borrowers had refused to accept the notices on earlier occasions and that they were served through affixation of the notices at the premises. Thereafter, on March 30, 2016, the learned arbitrator recorded a formal order, to proceed *ex parte* against the Borrowers. The arbitral tribunal, by the Award, directed that a total amount of INR 1,43,92,456/- was payable to Respondent No. 1 and an amount of INR 62,57,590/- was payable to Respondent No. 2 in respect of their claims. The arbitral tribunal further awarded pendente lite and future interest till realisation of the awarded amounts at the rate of 12% per annum. The arbitral tribunal also awarded costs, which it quantified at INR 80,000/-. Aggrieved by the Award, the Petitioner filed a petition before the DHC, on the ground as set out in Section 34(2)(a)(iii) of the 1996 Act, that the Petitioner was not given a proper notice of appointment of the arbitral tribunal or of the arbitral proceedings and, was unable to defend the case.

Issue

Whether the Petitioner was served due notice of the arbitral proceedings and had full opportunity to defend the case instituted by the Respondents.

Arguments

Contentions raised by the Petitioner:

The Petitioner averred that she had divorced Mr. Nitin Chawla on March 5, 2016 and had been residing separately since January 15, 2014. It was further averred that neither did the Petitioner have anything to do with the Borrower Company nor was she a working director in the Borrower Company and, all debts and liabilities borne by the Borrower Company were required to be discharged by Mr. Nitin Chawla. The Petitioner assailed the Award on the sole ground that the Petitioner did not have any notice of the arbitral proceedings. It was further submitted that the Petitioner did not participate in any business activities of the Borrower Company and was made a director therein merely for registration purposes. Further, due to temperamental differences, she had divorced Mr. Nitin Chawla in the year 2016 and had been assured that she would be removed as a director of the Borrower Company.

The Petitioner argued that the Award was liable to be set aside as no communication was received by the Petitioner from the Respondents. Further, the Respondents were well aware that the Petitioner had divorced Mr. Nitin Chawla and had moved her residence to property bearing no. B-5/12, Paschim Vihar, Delhi- 110063 ("**Paschim Vihar Address**"). The substitute address of the Petitioner was mentioned in the Agreement and despite knowing the same, the Respondents did not affect service at the said address. It was submitted that neither had the Petitioner received any notice for initiation of arbitral proceedings nor a notice from the arbitral tribunal nor a copy of the *ex parte* award prior to September 29, 2018 and, therefore, was unable to place her defense. It was also argued that the Petitioner had not authorized Mr. Gaurav Soni to appear on her behalf.

Contentions raised by the Respondents:

It was contended that the Petitioner had signed the power of attorney nominating the Respondents to act, take possession, create mortgage, to register property in the land registry or municipal records along with a letter of continuity, undertaking cum indemnity, along with letter of declaration, letter evidencing deposit of title deeds among other documents. Further, the Petitioner, being a director of the Borrower Company was liable for its acts and omissions. The Award duly recorded deemed service of notice of the arbitration proceedings on the Petitioner. It was further submitted that the notice was sent through e-mail. In addition, *dasti* (by hand) service was also affected. It was argued that Mr. Gaurav Soni had appeared on behalf of the Petitioner and, on subsequent non-appearance on March 17, 2016, the sole arbitrator proceeded *ex parte* against the Petitioner. Arguing that the factum of divorce between the Petitioner and Mr. Nitin Chawla was not relevant for the present petition, and referring to master data of the Borrower Company managed by the Ministry of Corporate Affairs, it was submitted that the Petitioner, being the director of the Borrower Company, was actively involved in its affairs.

Observations of the Delhi High Court

The DHC observed that the arbitral tribunal had made a noting that the notice dated February 1, 2016 had been sent to the Petitioner at A-156, Second Floor, Meera Bagh, Delhi – 110087 ("**Matrimonial Home**") and her Paschim Vihar Address. The envelope containing the notice sent to her Matrimonial Home bore the noting "refused". On the basis of the aforesaid the DHC found merit in the Petitioner's contention that there was no material to indicate that the Petitioner had refused service of the notices at her Paschim Vihar Address. Section 3 (*Receipt of written communications)* of the 1996 Act provides that notice is deemed to be served "*if it is sent to the addressee's last known place of business, habitual residence or mailing address by registered letter or by any other means which provides a record of the attempt to deliver it*". The DHC noted the postal receipt indicating that the notice was sent by speed post at the Petitioner's Paschim Vihar Address and, thus, the Petitioner would be deemed to be served at the said address. That being said, the DHC pointed out that it was not established that, in fact, the Petitioner was served the notices or was aware of the proceedings. Considering that the arbitral tribunal had proceeded on the basis that the Petitioner had refused service of the notice, the DHC acknowledged that there was no evidence or any material to indicate that the Petitioner had refused service of the notice sent to her at her Paschim Vihar Address.

Although *dasti* notices were served on the Borrower Company, the Respondents had not requested for *dasti* notices to be served on the Petitioner and admittedly, there was no material on record to indicate that the Respondents had personally served any notice to the Petitioner. Considering that the notices served to the Petitioner at her Matrimonial Home had been returned with the noting "refused", the DHC deemed the assumption made by the learned arbitral tribunal that the Petitioner was duly served as a rebuttable assumption. Noting the matrimonial dispute between the Petitioner and her husband, the DHC observed that the order dated August 18, 2015 passed by the Family Court indicated that the Petitioner had left her Matrimonial Home on January 15, 2014. She had thereafter, been residing at the Paschim Vihar Address. Concededly, the Respondents were aware of the said address.

Considering the circumstances, the DHC opined that it was difficult to accept that the notice dated February 1, 2016 issued by the arbitral tribunal was duly served on the Petitioner at her Matrimonial Home on account of the noting "refused". The DHC stated that there was ample material on record to indicate that the Petitioner was not residing at the said address on February 1, 2016.

The DHC observed that the arbitral tribunal had proceeded on the basis that since Mr. Gaurav Soni had appeared on behalf of the Borrowers, including the Petitioner, the Petitioner had been duly served the notice regarding the arbitral proceedings and had willfully chosen not to appear before the tribunal. However, Mr. Gaurav Soni did not furnish any authority from the Petitioner to represent her before the arbitral tribunal. The DHC thus affirmed the Petitioner's claims that she had not authorized Mr. Gaurav Soni or any other person to appear in the arbitral proceedings as she was not aware of the same, and accepted that Mr. Gaurav Soni had not appeared on the instructions of the Petitioner but of her ex-husband.

Decision of the Delhi High Court

The DHC thus held that the Respondents had failed to establish that the Petitioner was duly served the notices regarding constitution of the arbitral tribunal or had due notice of the arbitral proceedings at the material time. The DHC agreed that there was merit in the Petitioner's contention that she did not have notice of appointment of the arbitral tribunal or of the arbitral proceedings. Hence, the DHC set aside the Award insofar as the Petitioner was concerned, clarifying that the Award is not interfered with in so far as the other Borrowers are concerned. The DHC further clarified that the Respondents were at liberty to institute fresh proceedings against the Petitioner.

VA View:

The DHC has through this Judgement clarified that an arbitral award can be set aside, if notice of initiation of arbitral proceedings is not duly served to any of the parties to the dispute, with regards to that party. The DHC has upheld the rationale behind sending notice of institution of arbitral tribunal and initiation of arbitral proceedings, that is, the parties to the dispute against whom a claim is made should know what the claims are. In response to such notice, the recipient of the notice may accept the claims either wholly or partially.

Service of notice is crucial for the parties to understand the claims against them and to analyze whether the claims are tenable in light of the factual matrix of the dispute, thereby allowing them to defend themselves. Thus, not serving a notice to any of the parties to the dispute takes away a full opportunity to defend the case instituted. Hence, the DHC has rightly established that improper service of notice can consequently result in the arbitral award being set aside qua such party.

Contributors:
Dharmesh Khandelwal, Krithika Dineshan, Oorja Chari, Simran Gupta and Simrann Venkkatesan.

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Contact Details :

www.vaishlaw.com

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

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

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