Between the lines...

VAISH ASSOCIATES ADVOCATES ESTD. 1971

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Key Highlights

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I. BHC: Once parties acknowledge existence of arbitration clause, court can appoint arbitrator even if stamp duty is insufficiently paid.

The Bombay High Court ("**BHC**") has in the judgement dated February 28, 2022 ("**Judgement**"), in the matter of ***Pigments and Allieds v. Carboline (India) Private Limited and Official Liquidator and Liquidator of Octamec Engineering Limited [Arb. Application 225 of 2016]*** held that once parties acknowledge existence of arbitration clause, court can appoint arbitrator even if stamp duty is insufficiently paid.

Facts

Pigments & Allieds, a partnership firm ("**Applicant**") filed an application under Section 11 of the Arbitration and Conciliation Act, 1996 ("**Act**") and sought appointment of a sole arbitrator in furtherance of invoking the arbitration clause under a Tripartite Agreement dated February 06, 2013 ("**Agreement**"), executed between the Applicant, Carboline (India) Private Limited ("**Respondent no. 1**") and Official Liquidator and Liquidator of Octamec Engineering Limited ("**Respondent no. 2**") (collectively referred to as "**Respondents**"). A original copy of the Agreement was not available with any of the parties.

As per the Agreement, the Applicant was required to carry out work including construction and maintenance for Vodafone Shared Services Limited pursuant to a Subcontractor Agreement dated September 18, 2012 between the Respondents inter se ("**Subcontractor Agreement**"). Essentially the work involved supply and application of intumescent paint fire protection system and anti- corrosive paint to steel columns, fire and rust protection systems for the Vodafone Data Centre. The Respondent no.2 had placed a work order and a purchase order ("**PO**") issued under the Subcontractor Agreement on October 08, 2012, on the Respondent no.1 for supply and application of the aforesaid. The PO was placed by the Respondent no. 1 on the Applicant for supply of paint, as aforesaid for a consideration of Rs.18,00,77,644/- approx. Payment was to be made by way of a Letter of Credit ("**LoC**") of 90 days.

Pursuantly, Applicant had ordered 21 full container loads of the paint from Jordan. But the Respondent no. 1 had defaulted in making payments. The Respondent no. 1 apparently entered into negotiations with the Applicant to revise payment terms. Thereafter a new purchase order dated December 26, 2012 ("**NPO**") was issued reflecting negotiated terms for supply of 3,32,597 ltrs. (approx.) of paint for a consideration of Rs.19,19,13,125/- approx. The consignments had begun arriving at Nhava Sheva Port around January 2013 and the Applicant was incurring high demurrage charges and port charges. However, the Respondent no. 1 did not make payments under the NPO as well. The Respondent no. 1 then suggested that the Respondent no. 2 would open the requisite LoCs in favour of the Applicant and that the Respondent no. 2 should accept a combination of advances payable by post-dated cheques as guarantee against the LoCs being issued to the Applicant by the Respondent no. 2. Subsequently, the Agreement was executed on February 06, 2013. After much follow-up, some part payments were made in February 2013 and March 2013. Corresponding quantity of paint was released after payment was made towards detention charges, demurrage and customs duty.

The first shipment was then delivered at Vodafone site on February 26, 2013. The Applicant reminded Respondent no. 2 that they were incurring huge costs by way of customs duty, demurrage charges since the paint had not been collected due to the default of Respondent no. 1. The 3rd and 4th consignments were awaiting clearance and this has caused enormous loss to the Applicant. Under clause 10(b) of the Agreement, disputes between the parties were to be referred to Arbitration. The Applicant's case was that both the Respondents had avoided interacting with the Applicant and that they

had jointly and severally failed to make payments for a shipment. A claim for a sum of Rs.8,92,97,690/- approx. had been made along with Rs.1,24,04,618/- approx. towards demurrage, detention and other port charges. Interest had also been claimed @ 18% P.A. In these circumstances, the Applicant invoked arbitration by its letter-cum-demand notice dated June 2, 2016 ("**Demand Notice**"), and a sole arbitrator had been nominated.

It was stated that, on November 09, 2017, court had ordered impounding of the Agreement since it was found to be inadequately stamped. On December 10, 2019, the Superintendent of Stamps, Mumbai passed an order and issued a demand notice for payment of duty amounting to Rs.10,72,140/- , penalty of Rs.15,01,000/-, and a sum of Rs.200/- was payable towards indemnity.

Issues

1. Once parties acknowledge existence of arbitration clause, whether court can appoint an arbitrator even if stamp duty is insufficiently paid.

2. In the absence of the original copy of the Agreement, whether it was possible to impound a copy of the Agreement and have the copy stamped with ad-valorem duty payable.

Arguments

Contentions raised by the Appellant:

By virtue of the decision in **InterContinental Hotels Group *(India) Private Limited and Another v. Waterline Hotels Private Limited [Arbitration Petition (Civil) No.12 of 2019]***, when a court was faced with an issue of insufficient stamping, it was observed that there was no bar against proceeding and appointing an arbitrator. Further that after Applicant's response to the notice of demand, an order was expected to be passed, which could be challenged by way of a statutory appeal under Section 40 of the Maharashtra Stamp Act, 1958 ("**MSA**"). Relying upon the decision of ***Pradeep Shyamrao Kakirwar v. Dr. Seema Arun Mankar and Others [(2020) SCC OnLine Bom 799]***, the Applicant urged that though the photocopy was not an instrument, it did not come in way of stamp-duty being paid upon it pursuant to an impounding order of the court.

The Applicant cited the observations of the judgment in Intercontinental Hotels Group (supra), where the court held that until the larger bench decides the issue of existence of the arbitration agreement by virtue of reference made to the larger bench in ***N.N. Global Mercantile Private Limited v. Indo Unique Flame Limited and Others [(2021) 4 SCC 379]***, the court should ensure that the arbitrations are carried on, unless the issue before the court patently indicates existence of deadwood. In conclusion, it was Applicant's case that an arbitrator must be appointed.

Contentions raised by Respondents:

The Respondent no. 1 contended that the obligation to make payment was equally of the Respondent no. 2, which however, had been ordered to be wound-up. According to the Respondent no. 1, there was no dispute that existed and the question of appointment of an arbitrator did not arise. The Respondent no. 1 submitted that terms of the Agreement were not followed since there was no attempt to explore good faith negotiations as contemplated under Clause 10(a) of the Agreement prior to arbitration being invoked. According to the Respondent no. 1, unless the negotiations were held and had failed, arbitration could not have been invoked. Furthermore, it was contended that the Respondent no. 2 was also required to nominate an arbitrator and not just Respondent no. 1. It was the Respondent no. 1's case that an arbitration, if any, could only proceed as amongst the three parties. Hence, if the Applicant had a claim, it had to proceed against both the Respondents.

It was the Respondent no. 1's case that an instrument could be stamped even if it was a copy and the original were unavailable. Per contra, the Respondent no. 1 submitted that the court should not have proceeded and appointed an arbitrator since the instrument was not sufficiently stamped. Therefore the copy was inadmissible in evidence. According to the Respondent no. 1, stamp-duty of a sum of Rs.100/- on the Agreement had been paid in Tamil Nadu. However, the stamp-paper purchased in Tamil Nadu would have been of no relevance when the agreement was executed in Mumbai. According to the Respondent no. 1, ad-valorem stamp duty was to be paid under the MSA and no stamp- duty having been paid after it was brought into Maharashtra, the Agreement was not stamped at all.

Observations of the BHC

The BHC noted that the Chapter III of the Arbitration Act dealing with the composition of the arbitral tribunal requires the court to act on behalf of a party to an arbitration agreement when the party fails to act as required under Section 11(5) and 11(6). Applying the above provisions to the case at hand, the BHC found that when the document was first executed, it should have been stamped with duty chargeable as per Section 2(d) of MSA. In the instant case therefore, it was suffice to say that when the agreement was first executed, it appeared to have been executed by the Respondent no. 1 , a Chennai based company, on a stamp paper purchased in its name from a vendor in Chennai and thereafter sent to the two other parties being the Applicant and Respondent no. 2 in Mumbai, therefore duty chargeable in Chennai would be applicable. No doubt, the Agreement mentioned that the agreement was executed in Mumbai, but that does not take away the possibility that first execution appears to be in Chennai. Thus, the BHC observed that, it would be upto the arbitral tribunal to consider this aspect of the case.

In the present case, on a fair reading of the provisions of the MSA, it was evident under definition 2(d) of the MSA that the Agreement was required to be stamped when it was first executed. The Agreement was first executed by the Respondent no. 1 presumably with appropriate stamp duty, since it was not the case of the Respondent no. 1 that it was under-stamped in Chennai. The BHC observed that as far as liability of duty on the instrument was concerned, Section 3 of the MSA provides that every instrument, which is not previously executed by any person and is executed in the State of Maharashtra on and after the commencement of the MSA, shall be chargeable with duty, as set out in Schedule-I of the MSA. The proviso to Section 3(b) of the MSA clarifies that a copy, whether true copy or not, including a facsimile image of the original instrument, on which duty is chargeable under the provisions of that section, shall also be chargeable with full stamp duty, as set out in Schedule-I of the MSA, if proper duty is not paid on such original instrument. Further, the BHC observed that, it was evident that under Section 7 of the MSA, unless it was proved that stamp duty had been paid on the Agreement, being the original instrument, duty chargeable under the MSA would have to be paid on a copy of the instrument.

In N.N. Global (supra), the Hon'ble Supreme Court had considered the validity of the arbitration agreement in an unstamped document holding that on the basis of the doctrine of separability, the arbitration agreement need not be stamped. The BHC noted the fact that N.N. Global (supra) also dealt with the Supreme Court's decision in ***Hindustan Steel Limited v. Dilip Construction Co [(1969) 1 SCC 597]***, which observed that the stamp act is a fiscal measure enacted to secure revenue of the state on certain classes of instruments. It was not enacted to arm a litigant with a weapon of technicality to meet the case of his opponent. The judgment reiterated that the stringent provisions of the stamp act are in the interest of the 'Revenue' and once that object is secured in accordance with law, the party taking itsclaim on the instrument will not be defeated on the ground of the initial defect in the instrument. Thus, the BHC was unable to accept the Respondent no. 1's contention that the Agreement was unstamped and that the BHC had a case of deadwood at hand.

The enquiry that the court was required to make was to ascertain whether an arbitration agreement existed between the parties and in that behalf, the Applicant was the claimant and the defendant was the Respondent no. 1. In any event, upon receipt of the Demand Notice, it was open to the Respondent no. 1 to state that the parties should engage in negotiations prior to acting on the invocation. However, the BHC found an averment in the Application that after the Demand Notice was served, neither the Respondent no. 1 nor the Respondent no. 2 had replied. The Respondents failed to establish that negotiations were proposed and they were denied by the Applicant. The BHC found no substance in the objection that under clause 10(a) of the Agreement, negotiations had not been held. In BHC's view, under Clause 10(a) of the Agreement, if negotiations were not initiated by either party, reference to arbitration would not be bad.

The BHC was unable to accept the contention of the Respondent no. 1 that, the Respondents were required to appoint an arbitrator jointly and not solely by the Respondent no. 1. The BHC observed that, the provisions of the Agreement clearly stated that where there was a claimant and a defendant, the claimant would appoint one arbitrator and the defendant the other. Hence, merely because the Respondent no. 2 was in liquidation, did not mean that the instant application had to be rendered ineffective or deadwood. The BHC noted that, it was upto the Applicant to decide whether it had a claim against the liquidator or not and proceed in accordance with law. The Applicant had chosen not to proceed against the Respondent no. 2.

The BHC cited that in the case of InterContinental Hotels Group (supra), the Supreme Court had considered the jurisdiction of the court to adjudicate on existence of an agreement at the pre-appointment stage, and the fact that case by case, courts have restricted themselves in occupying the space provided for the arbitrators in line with party autonomy. Furthermore, the BHC observed that notwithstanding the decision in ***Vidya Drolia v. Durga Trading Corporation [(2021) 2 SCC 1]***, which clearly expounded that courts have limited jurisdiction under Section 11(6) of the Act, the narrow exception carved was that court could adjudicate to cut out the deadwood.

Decision of the Bombay High Court

Pending the decision of the Collector of Stamps, the BHC was of the view that the non-availability of the original Agreement at this stage would not prevent the BHC from appointing an arbitrator. The BHC noted that, it was possible that the document might still be lying undiscovered with either of one of the parties and could surface any day. The Agreement and its contents having been accepted and relied upon by both sides, there was no merit in contending that the original Agreement being absent, no reference could be made. Further, in BHC's view, one need not await the decision of the claimant in the case at hand, as to whether or not to pay stamp-duty, as adjudicated. If this is not to be so, a large number of arbitration proceedings will be held up right at the inception, which is not desirable. It was left to the arbitral tribunal to decide admissibility of the Agreement. Mr. Rajendra M. Savant, Former Judge of the BHC, was appointed as sole arbitrator for and on behalf of the Respondent no. 1. The parties were asked to appear before the sole arbitrator on a date fixed by him.

VA View:

The BHC has in this Judgement correctly observed that, arbitration is seen as a speedy remedy. But if applicants and respondents who may have counter-claims, have to await the fate of adjudication of documents for stamping and conclusion of the statutory challenge, the purpose of arbitration may be defeated. Further, the decision in InterContinental Hotels Group (supra) was cited, wherein it was held that, when in doubt, one must refer the matter to arbitration.

In BHC's view, once parties are *ad-idem* on the fact that they have signed the writing containing an arbitration clause, the parties having acknowledged that an arbitration clause was embodied in the substantive contract, one cannot prevent the court from disposing an application under Section 11 of the Act.

II. NCLT: Resolution Plan cannot be rejected on a perceived grievance by a suspended director who failed to take steps.

The National Company Law Tribunal, Kolkata ("**NCLT**") has in its order dated February 17, 2022 ("**Order**"), in the matter of ***Anand Kariwala v. Partha Pratim Ghosh and Others [I.A. (IB) No. 20/KB/2021 in CP (IB) No. 533/KB/2018]***, held that a resolution plan cannot be rejected on a perceived grievance by a member of the suspended board who had not taken any positive steps to participate in the meetings of the Committee of Creditors ("**CoC**").

Facts

On an application made by Jain Construction Private Limited ("**Financial Creditor**"), the NCLT by order dated October 24, 2019, initiated Corporate Insolvency Resolution Process ("**CIRP**") against Kariwala Designers Private Limited ("**Corporate Debtor**") and Mr. Chhedi Rajbir was appointed as the Interim Resolution Professional ("**IRP**"). A resolution plan was submitted by ARSK Consultants Private Limited and AMPI Finance Private Limited ("**Resolution Plan**"). ARSK Consultants Private Limited and AMPI Finance Private Limited are collectively referred to as "**Resolution Applicant**".

Mr. Anand Kariwala, a member of the suspended board of directors of the Corporate Debtor ("**Applicant**"), received notices for the first, second and third CoC meetings. However, subsequent to the IRP's replacement by Mr. Partha Pratim Ghosh ("**Resolution Professional**"), the Applicant did not receive notices for the CoC meetings.

Thereafter, in the month of September, 2020, the Applicant received a notice for handing over the vehicle of the Corporate Debtor. Only upon receiving such notice did the Applicant come to know that several CoC meetings were held and that he had not been given notice of the same. The Applicant, on enquiry, was informed of the Resolution Plan which was under consideration before the CoC. Upon perusal of the Resolution Plan, it came to the knowledge of the Applicant that the Corporate Debtor was being sold as a going concern at an undervalued price.

On that account, the Applicant has filed the present Interlocutory Application ("**I.A.**") under Section 60(5) of the Insolvency and Bankruptcy Code, 2016 ("**IBC**"), seeking to set aside the Resolution Plan proposed by the Resolution Applicant on the ground that the same is undervalued.

Issue

1. Whether the Applicant has a locus standi to object against the approval of the Resolution Plan.

2. Whether the adjudicating authority can interfere with the commercial wisdom of the CoC.

Arguments

Contentions raised by the Applicant:

Firstly, the Applicant submitted that he did not receive notices to the CoC meetings after IRP's replacement by the Resolution Professional. Only upon receiving a notice to handover the vehicle of the Corporate Debtor, did he come to know that several CoC meetings were held in the interim. Further, on Resolution Professional's refusal to share the Resolution Plan with the Applicant, the Applicant approached the NCLT for issuing a direction upon the Resolution Professional to serve the Resolution Plan upon the Applicant pursuant to which the Resolution Professional shared the Resolution Plan with the Applicant.

Upon perusal of the Resolution Plan, the Applicant observed that the Resolution Applicant had submitted a plan for INR 4,32,00,000/- (Indian Rupees Four Crores Thirty-Two Lacs only), whereas the sale of immovable property of the Corporate Debtor could alone fetch approximately INR 5,00,00,000/-. Therefore, by proposing to make a payment of INR 3,40,00,000/- to the sole Financial Creditor, the Resolution Applicant had ignored the very essence of the IBC and had thereby failed to (i) maximize the value of assets of the Corporate Debtor; and (ii) balance the interests of the stakeholders of the Corporate Debtor.

The Applicant, questioning the knowledge and experience of the Resolution Applicant, further contended that the Resolution Plan is faulty and biased depriving creditors other than the secured Financial Creditor of their dues.

Lastly, the Applicant contended that the Resolution Plan is being submitted in order to hand over the Corporate Debtor to Mr. Sanjay Kariwala, who claims to be the 100% shareholder of the Corporate Debtor and that a petition under Sections 240-241 of the Companies Act, 2013 is pending in respect thereof.

Contentions raised by the Resolution Professional:

The Resolution Professional submitted that the Applicant was informed of the appointment of the Resolution Professional on his registered e-mail address, which was in fact the e-mail address of his son Mr. Sharad Kariwala.

Mr. Sharad Kariwala, not being a member of the suspended board of directors was not permitted to attend the other CoC meetings. Moreover, notices of the CoC meetings were circulated to all the suspended board of directors and notice had also been sent to registered e-mail address of the Corporate Debtor. Further, the Resolution Plan was shared with the Applicant after the Applicant submitted the Non-Disclosure Agreement.

The Resolution Professional further submitted that immovable properties, moveable properties and financial assets of the Corporate Debtor were separately valued by two registered valuers and the average of the two valuations was considered as the fair value/liquidation value.

The Resolution Professional denied the contention of the Applicant that the Resolution Plan was faulty or biased and declared that the interests of all the stakeholders of the Corporate Debtor had been considered. The Resolution Professional further denied that the CIRP had been conducted in a fraudulent manner or in order to transfer the business of the Corporate Debtor from the present promoters to a group controlled by Mr. Sanjay Kariwala.

Contentions raised by the CoC:

The CoC submitted that the Applicant had no locus standi to file the I.A. The CoC further contended that its commercial wisdom cannot be questioned by the Applicant, who is a member of the suspended board of directors of the Corporate Debtor.

It was further submitted that the Applicant has filed the present I.A. owing to disputes and differences between the members of the suspended board of directors of the Corporate Debtor and that the I.A. has been filed with the malafide intention of driving the Resolution Applicant away in order to direct the Corporate Debtor into liquidation.

Moreover, the Applicant chose not to appear in the meetings of the CoC on his own account, despite receiving notices of the same.

With regard to the contention of the Applicant that the Resolution Applicant does not have any prior knowledge or experience in the line of business of the Corporate Debtor, the CoC submitted that the Corporate Debtor is merely into trading and retailing of sarees, which is not considered to entail skills requiring high level of technical or business expertise.

Lastly, reliance was placed by the CoC on the judgment of the Hon'ble Supreme Court in the case of ***Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta and Others [(2020) 8 SCC 531]***, submitting that the commercial wisdom of the CoC in approving the Resolution Plan cannot be challenged by the Applicant or any other person.

Observations of the NCLT

The NCLT observed that once the Corporate Debtor has been admitted into CIRP, the board of directors of the Corporate Debtor is suspended and its powers are transferred to the IRP as envisaged in Section 17(1)(b) of the IBC. The function of the suspended board of directors is limited to assisting and cooperating with the IRP/Resolution Professional for the smooth resolution of the Corporate Debtor. However, the suspended board of directors is not barred from objecting the act of the Resolution Professional, if such act is prejudicial to the Corporate Debtor, or is in violation of any law or procedural requirement.

The NCLT, relying on a catena of judgments of the Hon'ble Supreme Court, reiterated that the adjudicating authority is to refrain from intervening with the commercial wisdom of the CoC. The adjudicating authority is bound to act within the four corners of Section 30(2) of the IBC. In NCLT's view, the Resolution Plan submitted by the Resolution Applicant was in compliance with Section 30(2) of the IBC and was consequently approved by the NCLT.

With respect to the objection of the Applicant that the Resolution Plan does not maximize the assets of the Corporate Debtor, thus violating the object of the IBC, the NCLT observed that the Applicant had failed to consider that the primary objective of the IBC is not only to maximize the assets of the Corporate Debtor, but also to give the Corporate Debtor a new lease of life.

The NCLT further observed that, the Hon'ble Supreme Court in its judgment in ***Ebix Singapore (P) Ltd. v. Committee of Creditors of Educomp Solutions Limited [2021 SCC OnLine SC 707]***, held that inordinate delays cause commercial uncertainty, degradation in the value of the corporate debtor and makes the insolvency process inefficient and expensive.

Decision of the NCLT

The NCLT, in furtherance of its aforementioned observations, dismissed the Applicant's I.A. and held that the Resolution Plan has been submitted to revive the Corporate Debtor as a going concern and is in compliance with Section 30(2) of the IBC. Therefore, a Resolution Plan cannot be rejected based on a perceived grievance by a member of the suspended board of the Corporate Debtor who has not taken any positive steps to participate in the meetings of the CoC.

VA View:

The NCLT correctly observed that upon admission of the Corporate Debtor into CIRP, the IRP/Resolution Professional is in the driver's seat for directing the CIRP and takes over the reins of the Corporate Debtor to manage the Corporate Debtor for its benefit. Although initiation of CIRP against the Corporate Debtor does not bar the suspended board of directors from objecting to the acts of the Resolution Professional (*if such acts are prejudicial to the interests of the Corporate Debtor or is in violation of any law or procedural requirement*), a resolution plan cannot be rejected merely on a perceived grievance by a member of the suspended board of the Corporate Debtor who failed to take steps to participate in the meetings of the CoC.

Further, the NCLT's reasoning emphasized that the process of CIRP should be construed as a primary mechanism for corporate rescue and not the first step towards corporate death. That is to say that, liquidation followed by dissolution is supposed to be the last resort and should only take effect if CIRP fails.

The NCLT through this Order reinforced the supremacy of the financial creditors and their commercial wisdom, so far as the feasibility and viability of the Resolution Plan is concerned. Therefore, time being the essence of resolution process, the commercial wisdom of the CoC has yet again been given paramount status with limited judicial intervention.

III. NCLAT: There is no conflict between Section 17B of the Employees Provident Fund and Miscellaneous Provisions Act, 1952 and the Insolvency and Bankruptcy Code, 2016.

The National Company Law Appellate Tribunal ("**NCLAT**") has in its judgement dated March 11, 2022 ("**Judgement**"), in the matter of ***Sikander Singh Jamuwal v. Vinay Talwar Resolution Professional and Others [Company Appeal (AT) (Ins)No. 483 of 2019]*** held that there was no conflict between Section 17B *(Liability in case of transfer of establishment)* of the Employees Provident Fund and Miscellaneous Provisions Act, 1952 ("**EPF Act**") and the Insolvency and Bankruptcy Code, 2016 ("**IBC**"), owing to which Section 238 of the IBC (*Provisions of the IBC to override other laws)* would not come into force. Hence, the payment or non-payment of provident fund ("**PF**") dues is not a matter of commercial wisdom, and necessary compliance of law is a must.

Facts

In the instant case, the appeal had been filed before the NCLAT under Section 61 *(Appeals and Appellate Authority)* of the IBC against the impugned order dated April 2, 2019 ("**Impugned Order**") passed by the National Company Law Tribunal, New Delhi ("**NCLT**"). The appellant was an ex-employee of M/s Applied Electromagnetics Private Limited ("**Respondent No. 3**"/"**Corporate Debtor**") who worked as a supervisor ("**Appellant**") and he had total outstanding dues of INR 12,49,702/-.

The Appellant complained that the employees and workmen are the backbone of the Corporate Debtor in corporate insolvency resolution process ("**CIRP**"), who stood by it, by not resigning even when their rightful dues and salaries were not being paid / irregularly paid, much prior to the CIRP. Further, the Appellant complained that the resolution plan ("**Plan**") had not considered the full PF dues which amounted to INR 1,35,06,391/- full dues minus the amount of INR 78,00,000/- considered in the Plan ("**PF Dues**") of the employees, which Respondent No. 3 in CIRP was supposed to remit to the PF Authority under the EPF Act for the default period from October 1, 2012 to March 31, 2018, as assessed, and communicated by the Assistant Provident Fund Commissioner Noida, by its order dated March 19, 2019 ("**APFC Order**").

Pursuant to the issue of demand notice to Respondent No. 3 by one of its employees and on the subsequent filing of his petition, the NCLT by its order dated October 26, 2017, initiated the CIRP of Respondent No. 3 under Section 9 *(Application for initiation of corporate insolvency resolution process by operational creditor)* of the IBC. Mr. Naveen Kumar Jain was appointed as the Interim Resolution Professional ("**IRP**") by the NCLT who took charge on November 18, 2017. Subsequently, Mr. Vinay Talwar, the Resolution Professional ("**RP**"/ "**Respondent No. 1**") was confirmed by the NCLT on January 29, 2018. The liabilities of the Corporate Debtor as verified by the RP, amounted to INR 68.50 crores.

S.M. Milkose Limited, the resolution applicant ("**Respondent No. 2**"), had provided an amount of INR 12.99 crores towards settlement of all past dues and liabilities of the Corporate Debtor which included an amount of INR 9 crores towards secured financial creditors and INR 50 lakhs towards unsecured financial creditors. The employees and workmen were being given an amount of INR 1.03 crores against the claim of INR 8.17 crores. The Impugned Order stated that the Respondent No. 2 would infuse INR 5 crores as working capital requirement of the Corporate Debtor out of the sale proceeds of the assets of the Corporate Debtor. The Respondent No. 2, who was also one of the financial creditors of the Corporate Debtor, submitted the Plan. The Plan, after revisions, was submitted by the Respondent No. 2 to the RP, and was subsequently approved in the 9th meeting of the committee of creditors ("**CoC**") of the Corporate Debtor held on July 21, 2018. The Government of India by an order under Section 7A *(Determination of moneys due from employers)* of the EPF Act, has determined an amount of INR 1,35,06,391/- as the dues from the Corporate Debtor for the period up to March, 2018, against which only INR 78 lakhs had been provisioned for in the Plan submitted by the Respondent No. 2. The NCLT had approved the Plan by Impugned Order in terms of the approval of the CoC and had observed that "*While we are not endorsing any specified waivers or extinguishing of claims, the Resolution Applicant shall be entitled to all such waivers as are legally permissible under law*.".

Respondent No. 1, Respondent No. 2 and Respondent No. 3 are collectively referred to as "**Respondents**". In view of the above, the Appellant in the instant case prayed for setting aside the Impugned Order.

Issue

Whether the non-payment of PF Dues by the Respondent No. 2 in the Plan is permissible.

Arguments

<u>Contentions raised by the Appellant</u>:

The Appellant submitted that there was a misconduct on the part of the Respondent No. 1 in calculating the PF amount.

The Appellant alleged that there was a disparity in releasing the percentage of payment between the dues of financial creditors and the rightful dues of employees and workmen. Calling the plan discriminatory and non-payment of PF Dues a violation of the provisions of the EPF Act, it was also alleged by the Appellant that initiation of CIRP had been filed first by the employees and workmen under Section 9 of the IBC, and their interest was not taken care of in the Plan. The Plan provided for unequal treatment to the employees and is violative of the principles enshrined under Article 14 of the Constitution of India. The Appellant submitted that apart from the fact that the Plan was discriminatory insofar as it relates to the employees, the financial creditors had been paid much more (21.6%) than the operational creditors (12.67%).

Further, the Appellant complained that it had not been paid the gratuity amount as required under the Payment of Gratuity Act, 1972. The Appellant highlighted the large gap between the percentage of payment released to the financial creditor and the workmen. The Appellant challenged the basis on which Respondent No. 2, being engaged in a totally unrelated business in dairy industry, was eligible to take over a highly technical and specialized field working on projects of national importance requiring expertise in the related field. Further, it was alleged that the director of the Respondent No. 2 is a related party and is covered by Section 29A *(Persons not eligible to be resolution applicant)* of the IBC, thereby being disqualified for being considered as a resolution applicant.

Contentions raised by the Respondent:

The Respondent No. 1 submitted that there was no infirmity in the Impugned Order. It was submitted that against the verified claims of the workmen / employees of INR 8.17 crores, the RP had proposed an amount of INR 1.03 crores. It was argued that the appeal itself was not maintainable in view of the Hon'ble Supreme Court's judgment in case of ***Swiss Ribbon Private Limited and Another v. Union of India and Others [2019 4SCC 17]***. It was also submitted that it is the ultimate decision of the CoC to decide what to pay and how much to pay to each class or sub-class of creditors. The Respondent No. 1 contended that the payments approved by the CoC were the commercial decision of the CoC and the Appellant had no *locus standi* to challenge the commercial decision of the CoC.

Moreover, the Respondent No. 2 and the Respondent No. 3 contended that:

1. The resolution amount of INR 12.99 crores was more than the fair value and the liquidation value;

2. The non-priority due of workmen and employees were proposed at 7.5% but, however, on the request of the representative of the operational creditor, the same was enhanced to 10% and finally to 12.67% and the Plan had been unanimously approved in the 9th meeting of the CoC where the representative of the operational creditor was present; and

3. Since the Corporate Debtor had no separate gratuity fund, the employees were not eligible to get the gratuity, however, the Respondent No. 2 had committed to make a payment of 20% of the gratuity claim. The commercial decision of the CoC is non-justiciable. Hence, the appeal needs to be dismissed.

Observations of the NCLAT

The NCLAT observed that the Plan failed to consider the payment of PF Dues as computed in the APFC Order. The Plan was approved by the NCLT on April 2, 2019. The amount so computed is INR 1,35,06,391/-; whereas the provisions had been made for INR 78 lacs only. The NCLAT observed that financial creditors were being paid 21.6% whereas operational creditors were being paid 12.67%. The NCLAT clarified that by Section 30(2)(e) of the IBC, the Plan itself did not contravene any of the provisions of the law for the time being in force, however, the NCLAT further observed that the RP/NCLT had to look at the compliance of the provisions of law. As per the provisions of the EPF Act, the Respondent No. 2 was also liable to pay the contribution and other sums due from the employer under any provisions of the EPF Act as the case may be in respect of the period up to the date of such transfer.

The NCLAT observed that the explicit provisions of the EPF Act need to be complied with. When read with Section 17B of the EPF Act, it is amply clear that the Respondent No. 2 was required to pay the contribution and other sums due from the employer as per the provisions of the EPF Act. The NCLAT laid down that it was the duty of the RP/NCLT/NCLAT to see that the law is being complied with, and it is not a question of the commercial wisdom of the CoC. The NCLAT clarified that it was not looking into the aspect of parity for payment of financial creditors and operational creditors, as that came under the ambit of commercial wisdom of the CoC.

Decision of the NCLAT

The NCLAT relying on the judgement by the NCLAT in ***Tourism Finance Corporation of India Limited v. Rainbow Papers***

Limited and Others [2019 SCC Online NCLAT 910] laid down that since no provisions of the EPF Act is in conflict with any of the provisions of the IBC, the applicability of even Section 238 of the IBC did not arise. The PF Dues were not the assets of the Corporate Debtor as amply made clear by the provisions of Section 36(4)(a)(iii) of the IBC, which could be used for recovery in liquidation. The NCLAT directed the Respondent No. 2 to release full PF Dues in terms of the provisions of the EPF Act, immediately by releasing the balance amount of the PF Dues, thereby modifying the Impugned Order.

VA View:

The NCLAT in this Judgement has dealt with the interplay between the EPF Act and the IBC. The NCLAT has by this Judgement explained the scope of the commercial wisdom of the CoC. The instant Judgement has provided clarity on whether the entire PF dues need to be paid or not under a resolution plan. As rightly pointed out by the NCLAT, the PF dues cannot be utilized as assets to be used for recovery in liquidation. Through this Judgement, the NCLAT has provided much needed relief to the employees and workmen of a company undergoing CIRP, securing their right to receive PF and gratuity dues, so that the CIRP in its aftermath does not endanger the interests of the employees and workmen.

IV. NCLT: No insolvency proceedings can be initiated under the Insolvency and Bankruptcy Code, 2016, against personal guarantors of Non-Banking Financial Companies unless threshold of asset of INR 500 Crores is satisfied.

The Hon'ble National Company Law Tribunal, Jaipur ("**NCLT**") has by its order dated February 22, 2022, in the matter of ***Shapoorji Pallonji Finance Private Limited v. Rekha Singh [IA No. 229/JPR/2021 in C.P. No. (IB) - 25/95/JPR/2021]*** held that no insolvency proceedings can be initiated under the Insolvency and Bankruptcy Code, 2016 ("**IBC**") against personal guarantors of Non-Banking Financial Companies ("**NBFCs**") unless threshold of asset size of INR 500 Crores is satisfied.

Facts

The present interim application was filed by Rekha Singh, the personal guarantor ("**Applicant/ Personal Guarantor**") against Shapoorji Pallonji Finance Private Limited ("**Petitioner/ Financial Creditor**") seeking dismissal of company petition filed under Section 95 of the IBC against the Applicant ("**Petition**") on account of being non-maintainable.

The Petition was filed by the Financial Creditor to initiate insolvency resolution process in the case of the Applicant under Sections 60 and 95 of the IBC read with Rule 7(2) of Insolvency and Bankruptcy (Application to Adjudicating Authority for Insolvency Resolution Process for Personal Guarantors to Corporate Debtor) Rules, 2019.

The Personal Guarantor had, through a personal guarantee, secured repayment of a term loan advanced by the Petitioner to Jumbo Finvest (India) Limited ("**Jumbo Finvest**"), a NBFC, under a facility agreement. However, Jumbo Finvest had failed to make payment of interest amounts for the months of September, 2020 and October, 2020 and also failed to repay the principal amount instalment for the quarter ending in September, 2020.

The Petitioner was heard on June 17, 2021, and the following order was passed:
"[…] The Petitioner shall file a short affidavit with regard to the page reference of; the relevant demand notice, acknowledgement of the receipt of the said demand notice and the relevant emails within two weeks. The Petitioner shall also file copy of the master data of the Corporate Debtor for which the Respondent is a personal guarantor along with the affidavit…".

On July 12, 2021, the Applicant filed an interim application to set aside the aforesaid order on the basic premise that the same had been passed without hearing the Applicant. The said interim application was heard on July 20, 2021 and dismissed on the anvil.

Subsequently, after receipt of notice in the main Petition, the Applicant filed the present interim application seeking dismissal of the Petition.

Issue

Whether insolvency resolution process can be initiated against any personal guarantor of Jumbo Finvest, which is a NBFC and a financial services provider ("**FSP**"), by the Petitioner/ Financial Creditor under Section 95 of the IBC, particularly in

absence of any corporate insolvency resolution process ("**CIRP**") against the NBFC.

Arguments

Contentions raised by the Applicant:

Firstly, Jumbo Finvest is a NBFC registered with the Reserve Bank of India ("**RBI**"). As per the provisions of Section 3(7) of the IBC, the provisions of the IBC are not applicable to a NBFC. Secondly, there is no on-going insolvency process with respect to Jumbo Finvest and, therefore, the Petition filed by the Petitioner is not maintainable. Thirdly, as per Section 60 of the IBC, insolvency of a personal guarantor can be filed before the Hon'ble Adjudicatory Authority only if either CIRP or liquidation proceedings are pending against the corporate debtor before the National Company Law Tribunal. Therefore, no insolvency application can be filed against the personal guarantor of a NBFC and, hence, the Petition which had been filed by the Financial Creditor, under Section 95 of the IBC against the Applicant is not admissible.

The Applicant further submitted that a bare perusal of Section 60(2) of the IBC would go to show that it is necessary that CIRP has already been initiated against the corporate debtor prior to the filing of the insolvency application against the personal guarantor. As far as Section 60(1) of the IBC is concerned, the same does not deal with the situation as to when an insolvency resolution or bankruptcy against the personal guarantor can be initiated. It merely deals with the territorial jurisdiction with the NCLT for dealing with insolvency application.

The Applicant submitted that the notification no. S.O. 4139(E) dated November 18, 2019, issued by Ministry of Corporate Affairs ("**FSP Threshold Notification**") would go to show that CIRP can only be initiated against FSPs by the RBI, where the asset size of the NBFC is INR 500 Crores or more as per the last audited balance sheet. In this regard, it was submitted that as per the last audited balance sheet of Jumbo Finvest, the asset size as per the balance sheet as at March 31, 2020, is approximately INR 487 Crores and, therefore, the FSP Threshold Notification is not applicable in the present facts and circumstances. Further, even for the balance sheet as ending on March 31, 2021, as per the unaudited figures, the total asset size of Jumbo Finvest is approximately INR 407 Crores, which is far below the threshold limit as specified in the FSP Threshold Notification. In view of the aforesaid, it was clear that even the RBI is not empowered to initiate CIRP against Jumbo Finvest and accordingly, no personal insolvency application can be filed against the Personal Guarantor. Furthermore, even assuming though not admitting that CIRP can be initiated against Jumbo Finvest, even then, since no application either under Section 7 or 9 of the IBC is pending against Jumbo Finvest, the present application filed by the Petitioner is not maintainable and the same is required to be dismissed.

Lastly, it was submitted that the provisions of the Indian Contract Act, 1872 ("**ICA**") had nothing to do with the initiation of the insolvency against the Applicant.

Contentions raised by the Petitioner/ Financial Creditor:

The Petitioner contended that Section 60(1) of the IBC provides that insolvency resolution or liquidation of personal guarantors of corporate persons will go before the same National Company Law Tribunal having territorial jurisdiction where the registered office of the corporate person is located. Further, Section 60(1) of the IBC makes it clear that there is no necessity for a CIRP to exist against a corporate person for a CIRP to be entertained against the personal guarantor of such corporate person. It shows that Section 60(1) of the IBC would include in its ambit an individual covered by Section 95 of the IBC, if being sued in his capacity as a personal guarantor.

Furthermore, the contention of the Petitioner stating that in light of changes made to the IBC read with the Insolvency and Bankruptcy (Insolvency and Bankruptcy Proceedings of Financial Service Providers and Application to Adjudicating Authority) Rules, 2019 ("**FSP Rules**"), the Petitioner, being barred by law from initiating CIRP against a NBFC like Jumbo Finvest, can in no way mean that no CIRP can be initiated against personal guarantors of NBFCs till the RBI has initiated CIRP against the requisite NBFC.

The Financial Creditor further submitted that in addition to the provisions of the IBC, the contract of guarantee provided by the Applicant is also covered under the ICA. Section 128 of the ICA stipulates that the liability of the surety is co-extensive with that of the principal debtor, unless it is otherwise provided by the contract. In the present case, the liability of the Applicant is as if she herself was a co-obliger along with Jumbo Finvest. Thus, the Applicant can be proceeded against even under the ICA.

Observations of the NCLT

The NCLT observed that Jumbo Finvest is a FSP in terms of the FSP Rules. The FSP Threshold Notification clarified that insolvency resolution and liquidation proceedings of NBFCs with asset size of INR 500 Crores or more, as per last audited

balance sheet, shall be undertaken in accordance with the provisions of the IBC read together with the FSP Rules. As per the last audited balance sheet of Jumbo Finvest for year ending on March 31, 2020, and as per unaudited figures for the year ending March 31, 2021, Jumbo Finvest is excluded from the ambit of the FSP Threshold Notification.

In view of the above, Jumbo Finvest, the principal borrower, does not *stricto sensu* qualify within the tight definition of corporate person under the IBC, as the said definition excludes FSP. Further, the FSP Threshold Notification does not sweep it back into inclusion as a corporate person. So, as per debt being carried, such NBFC does not qualify as a corporate debtor.

Moreover, even if Jumbo Finvest is excluded by virtue of the FSP Threshold Notification, the generic inclusion by virtue of Rule 4 of the FSP Rules enunciates that in all the provisions relating to insolvency and liquidation proceedings under the IBC, the expression "corporate debtor" wherever it occurs, shall mean "FSP". This cannot lead to a situation that the phrase corporate debtor in IBC is contextually read as FSP, while the FSP Threshold Notification excludes certain FSPs. The FSP Rules are applicable only to the extent that the concerned NBFC/ Housing Finance Company qualifies under FSP Threshold Notification of asset size of INR 500 Crores or more. In the present case, as stated earlier, Jumbo Finvest does not fall within the ambit of the category of NBFC having asset size of INR 500 Crores or more and, therefore, the FSP Rules shall not be applicable to it. It is clear that Jumbo Finvest is not a corporate debtor in the present case.

Further, personal guarantor means an individual who is a surety in a contract of guarantee to a corporate debtor. Therefore, in order for an individual to be a personal guarantor, all the following pre-requisites are required to be fulfilled: (a) the individual has to be a surety; (b) there has to be a contract of guarantee; and (c) the individual has to be a guarantor to a corporate debtor. In this case, the guarantors to Jumbo Finvest do not strictly fall within the definition of personal guarantors and have existence as individuals only.

Insolvency resolution process can be initiated against the personal guarantor of a NBFC/ FSP irrespective of CIRP against the NBFC, provided that the concerned NBFC falls within the category of those FSPs having assets size of INR 500 Crores or more. The definition of personal guarantors under Section 5(22) of the IBC cogently implies that they can be recognised as personal guarantors under the IBC, subject to the condition, and only if, the person or entity for whom they have given guarantee is a corporate debtor. Therefore, as it is amply clear that Jumbo Finvest is not a corporate debtor, the guarantors of the aforesaid company cannot be considered as personal guarantors under provisions of the IBC. Since consequences of CIRP are drastic and almost penal for any entity, whether corporate or individual, definitions must be strictly construed.

Decision of the NCLT

In view of entirety of the foregoing, the NCLT held that, since Jumbo Finvest does not fall within the ambit of the category of NBFC having asset size of INR 500 Crores or more, it is not a corporate debtor, and hence the guarantors of Jumbo Finvest cannot be considered as personal guarantors under provisions of the IBC. Therefore, no insolvency proceedings can be initiated against them. The interim application filed by the Applicant was allowed and accordingly disposed of. The Petition by the Financial Creditor against the Applicant was not maintainable and was accordingly dismissed.

VA View:

The NCLT has, through this judgment, answered two critical questions pertaining to initiation of CIRP under the IBC. Firstly, application(s) for insolvency resolution process can be initiated against any personal guarantor to a corporate debtor irrespective of CIRP against the corporate debtor. Secondly, insolvency resolution process can be initiated against the personal guarantors of NBFCs/ FSPs, provided the concerned NBFC meets the criteria specified in the FSP Threshold Notification. In light of the above, financial creditors shall, before initiating any insolvency proceedings against personal guarantors, ensure that the NBFC falls within the category of those FSPs having asset size of INR 500 crores or more, and thus being included in the definition of corporate debtor under the IBC.

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