Between the lines...

VAISH ASSOCIATES ADVOCATES ESTD. 1971

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I. Supreme Court: A liability in respect of a claim arising out of a recovery certificate under the Recovery of Debts and Bankruptcy Act, 1993 would be a "financial debt" under the IBC and a holder of such recovery certificate would be a "financial creditor" under the IBC.

The Supreme Court ("**SC**") has in its judgment dated May 30, 2022, in the matter of ***Kotak Mahindra Bank Limited v. A. Balakrishna and Another [Civil Appeal No. 689 of 2021]*** held that a liability in respect of a claim arising out of a recovery certificate under the Recovery of Debts and Bankruptcy Act, 1993, would be a "financial debt" within the meaning of Section 5(8) of the Insolvency and Bankruptcy Code, 2016 ("**IBC**") and a holder of such recovery certificate would be a "financial creditor" under Section 5(7) of the IBC.

Facts

The appeal challenged the judgment and order dated November 24, 2020 passed by the National Company Law Appellate Tribunal, New Delhi ("**NCLAT**"), thereby allowing the appeal filed by the respondent no. 1, director of the corporate debtor, and reversing the order dated September 20, 2019 passed by the National Company Law Tribunal, Chennai ("**NCLT**"), whereby the application filed by the appellant, Kotak Mahindra Bank Limited ("**KMBL**"), under Section 7 of the IBC was admitted. The NCLAT while allowing the appeal held that the application filed by KMBL, was time barred and that issuance of recovery certificate would not trigger the right to sue.

During the years 1993 and 1994, Ind Bank Housing Limited ("**IBHL**") sanctioned separate credit facilities to three companies ("**Borrower Entities**"). The respondent no. 2, M/s. Prasad Properties and Investments Private Limited ("**Corporate Debtor**"), stood as the corporate guarantor/ mortgagor and mortgaged its immovable property to secure the aforesaid credit facilities sanctioned to the Borrower Entities.

The Borrower Entities defaulted in repayment of the dues and subsequently IBHL classified all the facilities availed by them as non-performing asset ("**NPA**") in November, 1997. Pursuant thereto, IBHL filed three civil suits before the High Court of Madras, against the Borrower Entities and the Corporate Debtor, for recovery of the amounts due. During the pendency of the suits, KMBL and IBHL entered into a deed of assignment dated October 13, 2006, wherein IBHL assigned all its rights, title, interest, estate, claim and demand to the debts due from Borrower Entities, to KMBL. Pursuant to the said deed, KMBL and the Borrower Entities entered into a compromise on August 7, 2006 ("**Compromise**").

It was claimed by KMBL that the Borrower Entities failed to make payments as per the Compromise and thus, KMBL issued a demand notice dated September 26, 2007 to them and the Corporate Debtor under Section 13(2) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 ("**SARFAESI**"). The said notice was followed by a possession notice dated January 10, 2008 issued under Section 13(4) of the SARFAESI, by KMBL due to default in payment by the Corporate Debtor of the amount demanded. KMBL further issued a winding up notice dated May 6, 2008 under the Companies Act, 1956 to the Corporate Debtor.

Aggrieved by the continuous default of payment by the Corporate Debtor and the Borrower Entities, KMBL filed three applications under Section 31(A) of the erstwhile Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (now known as the Recovery of Debts and Bankruptcy Act, 1993) ("**Debt Recovery Act**") before the Debt Recovery Tribunal ("**DRT**") for issuance of debt recovery certificates in terms of the Compromise entered into between the parties. The applications came to be allowed by the DRT and separate recovery certificates came to be issued against each of the

Borrower Entities and the Corporate Debtor.

On the basis of the aforementioned recovery certificates, on October 5, 2018, KMBL, claiming to be a financial creditor, filed an application under Section 7 of the IBC before the NCLT and sought initiation of corporate insolvency resolution process ("**CIRP**") against the Corporate Debtor, which was admitted. Respondent no.1, director of the Corporate Debtor filed an appeal which was allowed by the NCLAT. Aggrieved with the judgment of the NCLAT, KMBL filed the present appeal with the SC.

Issue

Whether the issuance of a recovery certificate in favour of the financial creditor would give rise to a fresh cause of action to initiate proceedings under Section 7 of the IBC.

Arguments

Contentions raised by KMBL:

KMBL submitted that the issue involved in the present proceedings is no more *res integra*. It was submitted that the SC has, in the case of ***Dena Bank (Now Bank of Baroda) v. C. Shivakumar Reddy and another [(2021) 10 SCC 330]*** ("**Dena Bank Judgment**"), held that once a claim fructifies into a final judgment and order/ decree, upon adjudication, and a certificate of recovery is also issued authorizing the creditor to realize its decretal dues, a fresh right accrues to the creditor to recover the amount specified in the recovery certificate. It is submitted that in view of the law laid down by the SC in the Dena Bank Judgment, the present appeal deserves to be allowed inasmuch as, the application under Section 7 of the IBC filed by KMBL was within the period of three years from the dates of issuance of the recovery certificates.

It was further submitted that the conduct of the respondents is that of a dishonest borrower. Having entered into the consent terms, which were decreed by the High Court of Madras and having not complied with the terms contained in the compromise decree, it is now not open to the respondents to oppose the admission of the application under Section 7 of the IBC.

In rejoinder, KMBL submitted that the Dena Bank Judgment correctly lays down the position of law. If the relevant provisions of the IBC are construed in correct perspective, the only conclusion that would be arrived at is that KMBL is a "financial creditor". It was submitted that the correct approach would be to consider the underlying transaction forming the basis of the proceedings initiated by the creditor culminating in a recovery certificate. If the underlying transactions are such that they constitute a financial debt and the creditor is a financial creditor, then that would be the determining factor for deciding the maintainability of the CIRP application. KMBL further submitted that the judgment debt does not lose its legal essence or character solely because it has fructified into a recovery certificate.

Lastly, KMBL submitted that the purpose of the IBC is to preserve the corporate debtor as an ongoing concern, while ensuring maximum recovery for all the creditors and that the provisions of the IBC have to be interpreted in such a manner as to advance the purpose of the IBC and not in a manner in which they defeat the object of the IBC.

Contentions raised by the respondents:

The respondents submitted that the cause of action has merged into the order of issuance of the recovery certificate by the DRT and, therefore, by application of the doctrine of merger, the debt no more survives. It was also submitted that the initiation of CIRP by KMBL would amount to filing of second proceedings for the very same cause of action and thus would be hit by the doctrine of *res judicata*.

It was further submitted that recovery certificates cannot be treated as "decree" for all purposes. It was submitted that a decree holder may initiate CIRP as a financial creditor, but the holder of a recovery certificate granted under Section 19(22) of the Debt Recovery Act is not entitled to initiate CIRP under the IBC as a financial creditor or a decree holder. Sub-sections (22) and (22A) of Section 19 of the Debt Recovery Act were brought on the statute book by 'The Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016 (Act No. 44 of 2016)', which was enacted on August 16, 2016 and brought into force from November 4, 2016. The respondents submitted that the deeming fiction contained therein applies only for the purposes of initiation of winding up proceedings. The deeming fiction cannot be extended for any other purpose.

Further, after November 15, 2016, that is, the date on which Section 255 of the IBC (*which omitted the application of the insolvency procedure under the Companies Act, 2013*) was brought into force, the recovery certificate holders lost their right to use their certificate as a "decree" for initiating winding-up proceedings under the Companies Act, 2013.

It was also submitted that the Dena Bank Judgment is *per incuriam*, and that it is rendered without considering the provisions of sub-sections (22) and (22A) of Section 19 of the Debt Recovery Act as well as certain provisions of the IBC. If the aforesaid provisions of the IBC and the Debt Recovery Act are considered in correct perspective, the conclusion that would be inevitable is that a decree holder is not a "financial creditor" and as such, is disentitled to invoke the provisions of Section 7 of the IBC. Further, the provisions of Section 14 of the IBC (*which deals with the imposition of moratorium on the corporate debtor*) would also amplify this position as the institution of suits or continuation of pending suits or proceedings against the corporate debtor including execution of any judgment, decree or order in any court of law, tribunal, arbitration panel or other authority is specifically prohibited.

Therefore, the NCLAT has correctly held that the application filed by KMBL under Section 7 of the IBC was beyond the period of limitation since issuance of recovery certificate does not give rise to a fresh cause of action and the timeline for the purpose of limitation would start in the year 1997 when the accounts of the Borrower Entities were declared NPA, and that no interference is warranted with the same.

Observations of the Supreme Court

The SC observed that in the Dena Bank Judgment, the court held in unequivocal terms that once a claim fructifies into a final judgment and order/ decree, upon adjudication, and a certificate of recovery is also issued authorizing the creditor to realize its decretal dues, a fresh right accrues to the creditor to recover the amount of the final judgment and/ or order/ decree and/ or the amount specified in the recovery certificate. Furthermore, the Dena Bank Judgment held that issuance of a certificate of recovery in favour of the financial creditor would give rise to a fresh cause of action to the financial creditor, to initiate proceedings under Section 7 of the IBC for initiation of the CIRP, within three years from the date of the judgment and/ or decree or within three years from the date of issuance of the certificate of recovery.

Applying principles of various judgments to the definition of "financial debt" under the IBC, it could clearly be seen that the words "means a debt along with interest, if any, which is disbursed against the consideration for the time value of money" are followed by the words "and includes". Thereafter various categories (a) to (i) have been mentioned in the definition of financial debt. It is clear that by employing the words "and includes", the Legislature has only given instances, which could be included in the term "financial debt". However, the list is not exhaustive but inclusive. The legislative intent could not have been to exclude a liability in respect of a "claim" arising out of a recovery certificate from the definition of the term "financial debt", when such a liability in respect of a "claim" simpliciter would be included in the definition of the term "financial debt".

Having held that a liability in respect of a claim arising out of a recovery certificate would be a "financial debt" within the ambit of its definition under clause (8) of Section 5 of the IBC, as a natural corollary thereof, the holder of such recovery certificate would be a financial creditor within the meaning of clause (7) of Section 5 of the IBC. As such, such a person would be a "person" as provided under Section 6 of the IBC who would be entitled to initiate the CIRP.

Insofar as the contention of the respondents with regard to Section 14(1)(a) of the IBC is concerned, the SC did not find that the words used therein could be read to mean that the decree holder is not entitled to invoke the provisions of the IBC for initiation of CIRP. The prohibition to institution of suit or continuation of pending suits or proceedings including execution of decree would not mean that a decree holder is also prohibited from initiating CIRP, if he is otherwise entitled to in law. The effect would be that the applicant, who is a decree holder, would himself be prohibited from executing the decree in his favour.

A perusal of the Dena Bank Judgment would reveal that the SC considered all the relevant provisions of the IBC and the earlier judgments of the court. The SC did not find any inconsistency in the Dena Bank Judgment with the earlier judgments of the SC on which reliance is placed by the respondents. The SC found that the contention that the Dena Bank Judgment being *per incuriam* to the statutory provisions and earlier judgments of the court, is wholly unsustainable.

It was sought to be argued by the respondents that the recovery certificate is for the limited purpose of initiation of winding up proceedings. If the contention is accepted, the word "limited" would be required to be inserted in Section 19(22A) of the Debt Recovery Act, between the words "shall be deemed to be decree or order of the Court" and "for the purposes of initiation of winding up proceedings". It is more than well settled that when the language of a statutory provision is plain and unambiguous, it is not permissible for the court to add or subtract words to a statute or read something into it which is not there.

Further, when the Legislature itself has provided that any recovery certificate issued under sub-section (22) of Section 19 of the Debt Recovery Act will be deemed to be a decree or order of the court for initiation of winding-up proceedings, which proceedings are much severe in nature, it will be difficult to accept that the Legislature intended that such a

recovery certificate could not be used for initiation of CIRP, which would enable the Corporate Debtor to continue as an ongoing concern and, at the same time, pay the dues of the creditors to the maximum.

Decision of the Supreme Court

With the aforesaid findings, the SC held that a liability in respect of a claim arising out of a recovery certificate would be a "financial debt" within the meaning of clause (8) of Section 5 of the IBC. Consequently, the holder of the recovery certificate would be a financial creditor within the meaning of clause (7) of Section 5 of the IBC. As such, the holder of such certificate would be entitled to initiate CIRP, if initiated within a period of three years from the date of issuance of the recovery certificate.

Therefore, the SC allowed the present appeal and set aside the judgment and order of the NCLAT. Undisputedly, the application for initiation of CIRP under Section 7 of the IBC had been filed by KMBL within a period of three years from the date of issuance of the recovery certificate.

VA View:

In this judgment, the SC has rightly analysed the intention of the Legislature, by stating that the list provided in in the definition of "financial debt" of the IBC is not exhaustive but inclusive and thus, the legislative intent could not have been to exclude a liability in respect of a "claim" arising out of a recovery certificate from the definition of the term "financial debt". In doing so, the court interpreted the IBC in such a manner so as to advance the purpose of the IBC and not in a manner in which they defeat the object of the IBC.

The SC also relied and rightly upheld the decision in the Dena Bank Judgment and observed that issuance of a certificate of recovery in favour of the financial creditor would give rise to a fresh cause of action to the financial creditor, to initiate proceedings under Section 7 of the IBC for initiation of the CIRP. This judgment brings further clarity towards understanding the provisions of the IBC and would significantly contribute to interpretation of the definition of the term "financial debt".

II. Supreme Court: Proceedings under SARFAESI cannot be continued against corporate debtor once CIRP is admitted and moratorium is ordered.

The Supreme Court ("**SC**") has in the judgement dated May 18, 2022 ("**Judgement**"), in the matter of ***Indian Overseas Bank v M/S RCM Infrastructure Limited and Another [Civil Appeal No. 4750 of 2021]*** held that once corporate insolvency resolution process ("**CIRP**") is initiated, all actions under Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 ("**SARFAESI**") to foreclose, recover or enforce any security interest are prohibited.

Facts

In the instant case, an appeal was preferred before the SC challenging the judgment dated March 26, 2021 ("**Impugned Order**") passed by the National Company Law Appellate Tribunal, Principal Bench, New Delhi ("**NCLAT**"), thereby dismissing the appeal filed by the Indian Overseas Bank ("**Appellant**"). The appeal to the NCLAT was in turn filed challenging the order dated July 15, 2020 passed by the National Company Law Tribunal, Hyderabad Bench-1, Hyderabad ("**NCLT**"), by which the NCLT had allowed the application filed by the former managing director ("**Respondent No. 2**") of M/s. RCM Infrastructure Limited ("**Corporate Debtor**"/ "**Respondent No. 1**") and set aside the sale of the assets of the Corporate Debtor. Respondent No. 1 and Respondent No. 2 are collectively referred to as "**Respondents**".

The Appellant had extended certain credit facilities to the Corporate Debtor. However, the Corporate Debtor failed to repay the dues and the loan account of the Corporate Debtor became irregular. On June 13, 2016, the loan account of the Corporate Debtor came to be classified as "Non-Performing Asset" ("**NPA**"). The Appellant issued a demand notice under Section 13(2) of the SARFAESI, calling upon the Corporate Debtor and its guarantors to repay the outstanding amount due to the Appellant. Since the Corporate Debtor failed to comply with the demand notice and repay the outstanding dues, the Appellant took symbolic possession of two secured assets mortgaged exclusively with it, in exercise of powers conferred on it under Section 13(4) of the SARFAESI, read with Rule 8 *(Sale of immovable secured assets)* of the Security Interest (Enforcement) Rules, 2002 ("**Rules**"). One of the said properties stood in the name of the Corporate Debtor and the other in the name of corporate guarantor. An e-auction notice came to be issued on September 27, 2018 by the Appellant to

recover the public money availed by the Corporate Debtor.

On October 22, 2018, the Corporate Debtor filed a petition under Section 10 (*Initiation of corporate insolvency resolution process by corporate applicant)* of the Insolvency and Bankruptcy Code, 2016 ("**IBC**") before the NCLT. In the first e-auction held on November 6, 2018, no bids were received. In the second e-auction held on December 12, 2018, three persons became successful bidders by offering jointly a price of Rs.32.92 crores for both the secured assets. On December 13, 2018, the sale was confirmed in favour of the successful bidders in the public auction. The successful bidders deposited 25% of the bid amount, that is, Rs.8.23 crore including the earnest money deposit of the said amount and the Appellant issued a sale certificate to them. The auction purchasers were directed to pay the balance 75% of the bid amount within 15 days, that is, prior to December 28, 2018. The auction purchasers addressed a letter to the Appellant seeking handing over of peaceful and vacant possession of the secured assets and also prayed for extension of time to pay the balance 75% of the bid amount till March 8, 2019, which was accepted by the Appellant.

NCLT, by order dated January 3, 2019, admitted the petition filed by the ex-promoter of the Corporate Debtor, and consequently the CIRP of the Corporate Debtor commenced, and moratorium under Section 14 *(Moratorium)* of the IBC was notified and an Interim Resolution Professional ("**IRP**") was also appointed.

The Appellant on January 21, 2019, filed its claim in Claim Form-C with the IRP, upon it coming to know about the admission of the insolvency petition filed by the Corporate Debtor. According to the Appellant, since the balance 75% of the bid amount was not yet received on the said date, it was not excluded from the claim filed before the IRP. During the pendency of the CIRP, the Appellant accepted the balance 75% of the bid amount, that is, Rs.24.69 crores on March 8, 2019. Upon receipt of the payment, the Appellant submitted its revised claim in Claim Form-C to the IRP on March 11, 2019. The Appellant also intimated the IRP about the successful sale of the said secured assets. The Respondent No. 2 thereafter filed an application praying before the learned NCLT to set aside the security realization during the CIRP period carried out by the Appellant or in the alternative to cancel the impugned transaction. By way of the order dated July 15, 2020, the learned NCLT passed an order thereby allowing the said application filed by the Respondent No. 2 and setting aside the sale of the property owned by the Corporate Debtor. Being aggrieved thereby, the Appellant filed an appeal before the NCLAT and the same was rejected by the Impugned Order. Being aggrieved by such order thereby, the present appeal was preferred by the Appellant to the Supreme Court.

Issue

Whether proceedings under the SARFAESI can be continued against the Corporate Debtor once CIRP is admitted and moratorium is ordered.

Arguments

Contentions raised by the Appellant:

It was argued that the very initiation of the voluntary insolvency proceedings under Section 10 of the IBC was with *mala fide* intent and as such, hit by Section 65 *(Fraudulent or malicious initiation of proceedings)* of the IBC. It was submitted that the demand notice was challenged by the Corporate Debtor by filing an application before the learned Debt Recovery Tribunal-II, Hyderabad ("**DRT**"). However, no stay was granted by the DRT in the said application. On the contrary, an order was passed on October 29, 2018 by the learned DRT, whereby confirmation of sale was stayed, subject to deposit of Rs.12 crores by the Corporate Debtor. The Corporate Debtor failed to do so. After that, with *mala fide* intent, instead of making payment, a petition came to be filed under Section 10 of the IBC by the Corporate Debtor for the sole purpose of stalling the sale. Though the issue with regard to Section 65 of the IBC was subsequently raised by the Appellant, neither the learned NCLT nor the learned NCLAT had considered the same.

It was argued that since the moratorium under Section 14 of the IBC had ceased to subsist after the order directing liquidation was passed under Section 52 *(Secured creditor in liquidation proceedings)* of the IBC, the secured creditors were allowed to realise their security interest. It was therefore submitted that there was no bar on the Appellant to realise its money. In view of the provision of Section 54 *(Dissolution of corporate debtor)* of the IBC, the sale was complete after the Appellant had received 25% of the bid amount and the said was confirmed. Relying on ***Vidhyadhar v. Manikrao and Another [(1999) 3 SCC 573]***, and ***B. Arvind Kumar v. Govt. of India and Others [(2007) 5 SCC 745]*** it was argued that merely because a part of the sale consideration was received subsequently, it could not affect the sale. Section 14(1)(c) of the IBC interdicts any action to foreclose, recover or enforce any security interest including any action under SARFAESI. However, it does not undo actions which have already stood completed.

Contentions raised by the Respondents:

The Respondents argued that the title of the secured assets cannot be conveyed to the auction purchasers merely upon confirmation of sale even before receiving full sale consideration. It was submitted that the title would be passed over only after receipt of the full consideration and issuance of sale certificate. Further, it was submitted that the contentions are totally contrary in view of various provisions of the SARFAESI, the Rules as well as Sections 14(1)(c), 31(1) and 238 of the IBC. Section 13(8) of the SARFAESI itself provides a right of redemption of secured assets to the owner/debtor. Upon approval of the Resolution Plan ("**RP**"), in view of Section 31(1) of the IBC, all the debts stand legally resolved and the same is binding on all parties including the Corporate Debtor, its employees, members, creditors, and all governmental dues and the successful resolution applicant would be entitled to start on a clean slate. Further, the jural relationship of creditor-debtor would get altered/severed under a new contract upon approval of a new RP. It was submitted that as a consequence, the security created under the old contract would stand released by operation of law and the relationship would be governed by the terms of the approved plan and the mortgage created under the old contract would get extinguished/novated.

It was submitted that in any case, in view of Section 238 *(Provisions of the IBC to override other laws)* of the IBC, the provisions contained therein will override all other laws for the time being in force and the provisions of the IBC would also prevail over any other instrument having effect by virtue of any other law. The continuation of any proceeding including the proceeding under the SARFAESI is totally illegal in view of Section 14(1)(c) of the IBC. It was, therefore, submitted that the continuation of any action under the SARFAESI by the Appellant and the receipt of the balance sale consideration was violative of Section 14(1)(c) of the IBC. The amount payable by the Corporate Debtor to the other financial creditors is much more than the amount received by the Appellant during the pendency of the CIRP.

Under the provisions of the IBC, all the financial creditors would be entitled to a share in the amount received upon realization of the assets of the Corporate Debtor and the Appellant cannot keep it in entirety. Section 65 of the IBC expressly provides for the mechanism and the remedy for addressing frivolous or malicious proceedings initiated under the SARFAESI. However, the Appellant chose not to take recourse to such proceedings. It was contended that as such, the allegations of *mala fide* were incorrect.

Observations of the Supreme Court

The SC observed that after the CIRP is initiated, there is moratorium for any action to foreclose, recover or enforce any security interest created by the Corporate Debtor in respect of its property including any action under the SARFAESI. The words "including any action under the SARFAESI Act" are significant. The legislative intent is clear that after the CIRP is initiated, all actions including any action under the SARFAESI to foreclose, recover or enforce any security interest are prohibited. The SC observed that the provisions of the IBC shall have effect, notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law. It has been consistently held by the SC that the IBC is a complete code in itself and in view of the provisions of Section 238 of the IBC, the provisions of the IBC would prevail notwithstanding anything inconsistent therewith contained in any other law for the time being in force.

Insofar as the judgment of the SC in the case of Vidhyadhar (supra) was concerned, the SC observed that it was held that even if the full price of the property has not been paid, the transaction of the sale will take effect and the title would pass on that transaction, the SC had further held that the real test is the intention of the parties. It was held that the parties must intend to transfer ownership of the property and that they must also intend that the price would be paid either in praesenti or in future. The SC however noted that in the said case, the defendant had not only executed the sale deed in favour of the plaintiff but had presented it for registration, admitted its execution before the Sub-Registrar before whom the remaining part of the sale consideration was paid and thereafter, the document was registered.

In the case of B. Arvind Kumar (supra), the property in question was a suit property and was sold in a public auction. The sale was confirmed by the District Judge, Civil and Military Station, Bangalore. What was held by the SC is that when a property is sold by public auction in pursuance of the order of the court and the bid is accepted and the sale is confirmed by the court in favour of the purchaser, the sale becomes absolute and the title vests in the purchaser. It was held that a sale certificate is issued to the purchaser only when the sale becomes absolute. It was held that when the auction purchaser derives title on confirmation of sale in his favour and a sale certificate is issued evidencing such sale and title, no further deed of transfer from the court is contemplated or required. Additionally, in the said case, the SC found that the sale certificate itself was registered.

The SC clarified that the instant case arises out of a statutory sale. The sale would be governed by Rules 8 and 9 *(Time of sale, issues of sale certificate and delivery of possession, etc.)* of the Rules. The sale would be complete only when the auction purchaser makes the entire payment and the authorised officer, exercising the power of sale, issues a certificate of sale of

the property in favour of the purchaser in the form given in Appendix V to the Rules. The SC noted that in the present case, the balance amount was accepted by the Appellant on March 8, 2019. The sale under the statutory scheme as contemplated under Rules 8 and 9 of the Rules would stand completed only on March 8, 2019.

The SC noted that this date fell much after January 3, 2019, on which date the CIRP commenced and moratorium was ordered. The SC was unable to accept the argument on behalf of the Appellant that the sale was complete upon receipt of the part payment. The SC concluded that in view of the provisions of Section 14(1)(c) of the IBC, which have overriding effect over any other law, any action to foreclose, recover or enforce any security interest created by the Corporate Debtor in respect of its property including any action under the SARFAESI Act is prohibited.

Decision of the Supreme Court

The SC held that the Appellant could not have continued the proceedings under the SARFAESI once the CIRP was initiated and the moratorium was ordered. Further it rejected the contention of the Appellant that the petition filed by the Corporate Debtor was *mala fide*.

VA View:

Through this Judgement, the SC determined on the issue of applicability of provisions under Section 14 of the IBC to a proceeding initiated in terms of the SARFAESI, in particular, auction sale. It confirmed that bar under Section 14 of the IBC extends to any action of enforcement of any security interest created by the corporate debtor, including any action under the SARFAESI.

Through this Judgment the SC has clarified the rationale behind the IBC as a legislation, which favours the resolution process of corporate debtors, over securing interest of individual claimants. The SC reiterated the legislative intent of the IBC that after the CIRP is initiated, all actions including any action under the SARFAESI to foreclose, recover or enforce any security interest are prohibited**.**

III. NCLT: IBC and RBI Guidelines are Disjoint Sets, there is no question of one prevailing over the other.

The National Company Law Tribunal, Kolkata (**"NCLT"**) has in its order dated May 17, 2022 (**"Order"**) in the matter of ***Hemant Kanoria v. SREI Infrastructure Finance Limited (Through its Administrator, Mr. Rajneesh Sharma) [IA (IB) No. 75/KB/2021 in CP (IB) No. 295/KB/2021]*** held that the Insolvency and Bankruptcy Code, 2016 (**"IBC"**) and guidelines issued by the Reserve Bank of India (**"RBI"**) are disjoint sets and there is no question of one prevailing over the other.

Facts

SREI Infrastructure Finance Limited (**"SIFL"**) and SREI Equipment Finance Limited (**"SEFL"**) are financial service providers undergoing Corporate Insolvency Resolution Process (**"CIRP"**) envisaged under the provisions of the IBC.

The RBI had issued a circular titled "Master Directions on Frauds – Classification and Reporting by commercial banks and select FIs" on July 1, 2016 (Updated as on June 3, 2017) (**"RBI Circular"**) directing the banks to report the fraud status of the accounts in default. Clause 8.9.5 of the RBI Circular provides for completion of forensic audit within a period of three months from the date of the Joint Lenders' Forum (**"JLF"**) authorizing the audit.

In the present case, two major creditors namely Axis Bank and UCO Bank had convened JLF meeting on March 24, 2021 and appointed KPMG Assurance and Consulting Services LLP (**"KPMG"**) to conduct the forensic audit. In view of Clause 8.9.5 of the RBI Circular, the forensic audit was supposed to be concluded by June 24, 2021.

Upon a petition filed by the RBI, on October 8, 2021, the NCLT initiated the CIRP of SIFL and SEFL and appointed Mr. Rajneesh Sharma as administrator of both the aforesaid companies. Pursuant to his appointment, the administrator appointed BDO India LLP (**"BDO"**) to carry out transaction audit of SIFL and SEFL and probe the vulnerable transactions as per the relevant provisions under the IBC.

Thereafter, Mr. Hemant Kanoria ("**Applicant**"), shareholder of SIFL and SEFL and a member of the suspended board of directors of SIFL preferred an application before the NCLT, *inter alia*, praying for setting aside the appointment of KPMG and restraining Axis Bank and UCO Bank from conducting and proceeding with the process of audit through KPMG.

Issues

1. Whether the NCLT has the jurisdiction to stop an audit commissioned under the RBI Circular.

2. Whether the IBC will prevail over the RBI guidelines.

Arguments

Contentions raised by the Applicant:

The Applicant submitted that an audit being conducted at the instance of some bankers cannot be continued after commencement of CIRP, which itself was initiated at the instance of the RBI and thereafter the administrator appointed BDO as transactional auditor to conduct investigation of vulnerable transactions.

The major contentions raised by the Applicant are briefly set out:

1. The Applicant is a member of the suspended board of directors of SIFL whose subsidiary is SEFL, and therefore has the *locus standi* to prefer the present application.

2. The KPMG report was completed on December 22, 2021, with a delay of nearly six months, and was therefore not in compliance with the timeline provided as per Clause 8.9.5 of the RBI Circular. In fact, as per Clause 8.9.6 of the RBI Circular, the entire exercise is stipulated to be completed within six months from the date when the first member bank reported the account as fraud.

3. KPMG conducted an audit without consulting the erstwhile management. Further, once a transactional auditor has been appointed under the IBC, a previous audit cannot continue. There cannot be a parallel forensic audit without consulting the erstwhile management at the instance of the bankers.

4. The IBC is recognized to be complete in itself and has overriding effect over any other legislation or instrument in the event / to the extent of any inconsistency whatsoever.

5. Basis perusal of the caveats and limitation to access to data whilst preparing the report as clearly mentioned in the KPMG report, it is evident that KPMG report is incomplete. KPMG has stated that the comments in the report may not be considered as definitive pronouncement.

6. If the purpose of the IBC is to revive or ensure continued existence of an enterprise and to maximize its value, it is imperative that the transaction audit being conducted under the IBC should get precedence.

7. On the one hand, KPMG conducted audit of SIFL and SEFL at the instance of the banks, whereas on the other hand, the banks were aware of and voted in favour of the administrator appointing a transaction auditor.

8. In the event if there is inconsistency between the KPMG report and the BDO report, it will give rise to a conflict situation.

9. Under Section 25(2)(j) of the IBC, it is the duty of the resolution professional (administrator in the present case) to file application for avoidance of transactions.

10. As the scope of investigation is common, it is the IBC and the report filed as per the provisions of the IBC, which shall prevail.

11. Previously there were preliminary reports prior to issuance of final report. This raises a serious apprehension that the contents of the report would have been modified at the behest of the bankers.

12. The RBI Circular is a framework laid down under which the banks have to act, and it cannot overhaul the framework of the IBC.

13. There is no explanation as to why the audit procedure was not completed by KPMG within the stipulated timeframe.

Contentions raised by Axis Bank and UCO Bank:

The submissions of Axis Bank and UCO Bank are broadly set out hereunder:

1. The resolution professional or liquidator who has to form an opinion about avoidance transactions are bound by numerous restrictions. For instance, if Section 43 (Preferential Transactions) of the IBC is referred to, the opinion formed by the resolution professional or liquidator will be restricted to only the limited purpose of that section, and also for a limited duration as stipulated therein.

2. The report submitted by auditors appointed by the resolution professional or liquidator under the provisions of the IBC is limited in scope, with limited consequences and to be given in respect of finite time periods.

3. The proceedings emanating from KPMG report before other Courts including Criminal Courts are not hit by moratorium under Section 14 of the IBC, as the moratorium pertains to the corporate debtor and not in respect of the erstwhile management or shareholders of the corporate debtor.

4. The banks have no role in determination of resolution professional to file applications. This does not preclude the lenders from commissioning a separate audit and taking an action independent of the IBC.

5. The Applicant wants the NCLT to assume the jurisdiction to stay the criminal aspects that have been thrown up by the audit commissioned by the lenders, and such a relief cannot be granted within the framework of the IBC. The NCLT has not been given the jurisdiction to look into matters that are beyond the IBC itself.

6. The issue of breach of timeline by KPMG in submitting its report lies between the banks and the RBI, and the Applicant cannot take any advantage of the same.

7. Forensic audit carried out under the Banking Regulation Act, 1949 and not under the provisions of the IBC cannot be stopped by the NCLT. In this regard, reliance was placed on ***BV Bhaskar Reddy v. Bank of India and Others [MANU/ND/1394/2021]*** decided on January 7, 2021 by NCLT, Hyderabad.

Contentions raised by KPMG:

KPMG submitted that the prayer sought by the Applicant asking KPMG to not continue the investigation is infructuous qua KPMG as the report has been submitted.

Observations and decision of the NCLT

Considering the KPMG report being submitted now, the NCLT observed that all other prayers sought by the Applicant have become infructuous and the only Prayer (b) remains to be answered, which is – seeking an Order to set aside the audit process conducted by KPMG in light of initiation of CIRP.

On the issue of jurisdiction of the NCLT, the NCLT observed that basis the powers vested under the IBC, the NCLT lacks the jurisdiction to stop an audit commissioned under the RBI Circular, the intent of which is altogether different.

Further, on the issue of whether the IBC will prevail over the RBI guidelines, the NCLT observed that the RBI circulars work in different fields and are, in a manner of speaking, disjoint sets. The adequacy or otherwise of KPMG's audit report would no doubt be determined by the lenders. As such, the NCLT held that there is no possibility of conflict between the two and there is no question of one prevailing over the other.

VA View:

The NCLT has rightly observed that the RBI circulars and guidelines operate in a different scope and framework and not necessarily overlap with the provisions of the IBC, in which scenario the question of inconsistency and / or one prevailing over the other does not even arise. Often many applications are filed before the National Company Law Tribunals, pitting some or the other legislation or instrument against the IBC, thereby seeking prayer that the provisions of the IBC shall prevail, in complete ignorance of the fact that there exists no inconsistency in the first place.

Further, the NCLT has correctly held that it is bound by limited powers and functions as envisaged under the IBC and cannot venture into adjudication of issues beyond its jurisdiction and cannot pass orders such as stopping audit process commissioned under the framework of RBI. The implication for the banks is that they are fully entitled to conduct forensic audits of borrowers under resolution process or liquidation and take action against the management responsible for the same without being circumscribed by the strict requirements that avoidance transactions have to be met under IBC.

IV. NCLAT: The NCLT does not have the power to suo-moto classify a transaction as a 'preferential transaction'.

The National Company Law Appellate Tribunal ("**NCLAT**") has in its judgement dated May 9, 2022 ("**Judgement**"), in the matter of ***Sahara India v. Shri Nandkishor Vishnupant Deshpande and Another [Company Appeal (AT) (Insolvency) No. 368 of 2021]*** held that the National Company Law Tribunal ("**NCLT**") does not have the power to *suo-moto* classify a transaction as a preferential transaction under the provisions of the Insolvency and Bankruptcy Code, 2016 ("**IBC**").

Facts

Sahara India, a registered partnership firm ("**Appellant**"), entered into a memorandum of understanding dated March 7, 2017 ("**MOU**") with Royal Refinery Private Limited ("**Corporate Debtor/ Respondent No.2**"), by which the Appellant advanced INR 39.95 Crores to the Corporate Debtor in various tranches commencing from April, 2018 to February, 2019 for the supply of future goods in the form of gold coins/gold ornaments ("**Gold Coins**"). The Gold Coins were to be supplied to the Appellant after January, 2019. As per the terms of the MOU, the advance payments made by the Appellant did not attract any interest.

The Appellant in its letter dated February 4, 2019 requested the Corporate Debtor to supply 10 kg of Gold Coins, which the Corporate Debtor confirmed to supply once the Gold Coins were manufactured. Upon the Corporate Debtor's failure to supply the Gold Coins, the Appellant by its letter dated February 28, 2019 enquired about the supply of the Gold Coins, to which the Corporate Debtor responded that the supply would be fulfilled after three to four months time due to a lack of factory staff.

In view of the above, the Appellant by its letter dated March 5, 2019 requested for a refund of the amount advanced by it to the Corporate Debtor. However, the Corporate Debtor requested to convert the amount advanced to it by the Appellant into an unsecured loan bearing a 10% p.a. rate of interest, till full and final payment. Consequently, the MOU was substituted with a loan agreement.

On November 13, 2019, Corporate Insolvency Resolution Process ("**CIRP**") was initiated against the Corporate Debtor, as a result of which Mr. Nandkishor ("**Resolution Professional/Respondent No.1**") took over control of the Corporate Debtor and invited public notice and claim. The Respondent No.1 and Respondent No.2 are collectively referred to as "**Respondents**".

Upon learning about initiation of CIRP against the Corporate Debtor, the Appellant, in its capacity as a financial creditor, submitted its claims amounting to a total of INR 42,61,33,333/- with the Resolution Professional. However, the Resolution Professional did not consider the claims of the Appellant as a 'financial debt' as a result of which, the Appellant, by way of an interlocutory application, challenged the decision of the Resolution Professional before the NCLT.

The NCLT by its order dated January 7, 2021 ("**Impugned Order**") compared the facts of the Appellant's case partially with ***Anuj Jain Interim Resolution v. Axis Bank Limited [(2020) 8 SCC 401]*** (the **"Anuj Jain Case**") and not only refused to classify the claim of the Appellant as a 'financial debt' but also treated the transaction as a preferential transaction in terms of Section 43(2)(a) of the IBC on the ground that the loan agreement dated April 15, 2019 executed between the Corporate Debtor and the Appellant was created seven months prior to initiation of CIRP, which is well within the two years look back period as prescribed under the IBC.

Therefore, the Appellant approached the NCLAT under Section 61 (*Appeals and Appellant Authority*) of the IBC, for setting aside the Impugned Order.

Issue

Whether the NCLT has the power to *suo-moto* classify a transaction as a preferential transaction under the provisions of the IBC.

Arguments

Contentions raised by the Appellant:

Firstly, the Appellant submitted that the dues payable to it by the Corporate Debtor were purely in the nature of 'financial debt' and that the NCLT could not consider the transaction as a 'preferenntial transaction' without an avoidance application being filed by the Resolution Professional or the liquidator under Section 44 of the IBC.

The Appellant submitted that the substitution of the MOU by the loan agreement amounts to novation of the earlier agreement with an entirely new agreement as per Section 62 of the Indian Contract Act, 1872. Further, the Appellant and the Corporate Debtor are not related parties. The operational debt of the Corporate Debtor was converted to financial debt only because of its inability to supply the goods to the Appellant, despite being granted certain leverage by the Appellant.

The Appellant referred to the Hon'ble Supreme Court's pronouncement in the Anuj Jain Case to contend that, for a transaction to fall within the mischief of Section 43 of the IBC, both the twin requirements of clauses (a) and (b) of Section 43(2) of the IBC coupled with either clause (a) or (b) of Section 43(4) of the IBC needs to be satisfied. Further, Section 44 of the IBC provides that it is the resolution professional or the liquidator, as the case may be, who is supposed to file an avoidance application with the NCLT for initiation of action under Section 43(1) of the IBC.

The Appellant submitted that Section 43 (*Preferential Transactions*) of the IBC, specifically deals with transactions pertaining to transfer of property or an interest thereof of a corporate debtor for the benefit of a creditor. However, in the instant case, that has not happened.

In view of the above, the Appellant prayed for setting aside the Impugned Order.

Contentions raised by the Respondents:

The Respondents submitted that since the liquidation order dated April 16, 2021 passed by the NCLT, is not under challenge and continues to remain in effect, the present appeal filed by the Appellant is infructuous and that the questions and issues raised in the appeal have become entirely academic and are of no legal consequence. Further, the Resolution Professional is no longer with the Corporate Debtor and one Mr. Arihant Nenawati has been appointed as the liquidator of the Corporate Debtor.

The Respondents submitted that the liquidator had issued a public announcement dated April 27, 2021 calling for claims from the stakeholders of the Corporate Debtor. However, the Appellant had not filed its proof of claim before the liquidator. The proof of claims submitted by the Appellant on March 3, 2020, to the Resolution Professional, cannot be categorized in any way as financial debt under Section 5(8) of the IBC.

The Respondents categorically stated that the money advanced to the Corporate Debtor under the terms of the MOU was towards future supply of Gold Coins. Hence, the disbursement of the advance amount was not against the consideration of time value of money as required under Section 5(8) of the IBC. It was at best an advance payment for supply of goods and hence is in the nature of an operational debt in terms of Section 5(21) of the IBC. Moreover, Section 5(8) of the IBC does not qualify a financial debt resulting from conversion of operational debt into a financial debt at a later date.

Furthermore, in light of the overriding provision in Section 238 of the IBC and the judgment of the Hon'ble Supreme Court in ***Gujarat Urja Vikas Nigam Limited v. Amit Gupta, [(2021) SCC Online SC 194]***, it becomes evidently clear that the provisions of the IBC can override a bilateral commercial contract, such as a loan agreement. Additionally, the terms of the loan agreement neither provided for a clear repayment schedule for the purported loan amount nor did it provide for consequences upon default on the part of the Corporate Debtor.

Therefore, the loan agreement was a sham and a collusive document to give fraudulent preference to the Appellant and the contention of the Appellant that the NCLT could not *suo motu* hold the transaction to be preferential as it was not one of the reasons provided by the Resolution Professional, is clearly erroneous and devoid of merit.

Observations of the NCLAT

The NCLAT observed that it was an undisputed fact that the money was received by the Corporate Debtor in different tranches in order to fulfill the supply of Gold Coins to the Appellant at a future date. It was also clear that the said advance payment did not attract any interest. Further, at the time of 'origination of transactions' from April 2018 to February, 2019, the money advanced was in the nature of operational debt and met the criteria of operational debt as enunciated in Section 5(21) of the IBC.

Neither of the parties during their respective submissions, stated that the Appellant and the Corporate Debtor are related parties. If they were not related parties, then the lookout period is a period of one year preceeding the insolvency commencement date as per Section 43(4)(b) of the IBC. Therefore, considering that the CIRP commenced in November 2019, the payments released from April 1, 2018 to June 30, 2018, in any way would not get covered under the ambit of Section 43 of the IBC and hence only two payments amounting to INR 2.5 Crore and INR 2.04 Crore, respectively, could be treated as preferential payment from the total advance payment of INR 39.95 Crore.

Stating the provisions of the IBC, the NCLAT observed that it is abundantly clear that transfers made in the ordinary course of business or financial affairs of the Corporate Debtor shall not be covered under preferential transactions.

The NCLAT observed that the MOU entered into in the year 2017 was meant for the supply of goods in the form of gold coins/gold ornaments and the order of initiation of CIRP reflects that the Corporate Debtor was in regular business of buying and selling gold bars. Therefore, the transaction between the Appellant and the Corporate Debtor was 'in the ordinary course of business'. Moreover, the parties not being related parties, only the transactions falling within a period of one year from initiation of CIRP could be covered under preferential transaction and not the entire advance amount.

Decision of the NCLAT

The NCLAT came to a conclusion that the NCLT in its Impugned Order has exceeded its jurisdiction while recording the finding to the effect that the Appellant and the Corporate Debtor are related parties, which is beyond the scope of the petition filed before the NCLT. That is to say that, the NCLT on its own accord, classified the parties as related parties, which is beyond the provisions of the IBC.

Drawing reference to the single judge order in the case of ***Mahender Singh Gill v. Chief Election Commissioner [(1978) 1 SCC 405]***, the NCLAT held that when a statutory functionary such as a resolution professional, has not filed an avoidance application for initiation of proceedings under Section 43 of the IBC, the NCLT by treating the transaction as a preferential transaction, has supplemented its order by a fresh reason through affidavit or otherwise and that the same is not acceptable under the provisions of the IBC.

The NCLAT, setting aside the Impugned Order, directed the NCLT to reconsider the instant case afresh and to decide the matter on its merits in accordance with law.

VA View:

The NCLAT in this Judgement has correctly observed that the NCLT cannot *suo-moto* classify a transaction as a preferential transaction. This Judgement adds to the development of the jurisprudence in the legislation, especially in relation to Section 43 (*Preferential Transactions and Relevant Time*) and its validity.

Further, the NCLAT emphasized that when a statutory functionary such as a resolution professional makes an order on certain grounds, its validity must be judged by the reasons mentioned therein and cannot be supplemented by fresh reasons in the shape of an affidavit or otherwise.

Therefore, setting aside the NCLT's decision, the NCLAT rightly held that the NCLT has exceeded its jurisdiction by firstly, considering the parties as related parties and further, by classifying the transaction between them as a preferential transaction without an avoidance application being filed by the Resolution Professional or the liquidator under Section 44 of the IBC.

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