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Between the lines...

A BRIEFING ON LEGAL MATTERS OF CURRENT INTEREST

KEY HIGHLIGHTS

* **Supreme Court**: Directors cannot escape penal liability in cheque dishonoring cases by citing company's dissolution.
* **Bombay High Court**: A share purchase agreement containing option to sell the shares does not amount to derivative contract, thereby does not violate provisions of SCRA.
* **NCLAT**: Fraud for the purpose of Section 66 of the IBC includes a debt where the debtor has no intention to repay.
* **NCLAT**: IBC does not contemplate multiplicity of applications against the same personal guarantor.

I. Supreme Court: Directors cannot escape penal liability in cheque dishonoring cases by citing company's dissolution.

The Supreme Court of India ("**SC**"), in the case of ***Ajay Kumar Radheyshyam Goenka v. Tourism Finance Corporation of India Limited [Criminal Appeal No. 172 of 2023]***, while deciding the ongoing proceedings under Negotiable Instruments Act, 1881 ("**NI Act**") as well as the ongoing Corporate Insolvency Resolution Proceedings ("**CIRP**") held that the scope of the proceedings under the NI Act and Insolvency and Bankruptcy Code, 2016 ("**IBC**") are very different and would not conflict with one another.

Facts

Tourism Finance Corporation of India Limited ("**Respondent**") granted a loan of INR 30 Crores to Rainbow Papers Limited ("**Corporate Debtor**") and subsequently entered into a loan agreement dated March 27, 2012 ("**Loan Agreement**"). Mr. Ajay Kumar Radheyshyam Goenka ("**Appellant**") was the promoter as well as the managing director of the Corporate Debtor.

The Corporate Debtor issued a post-dated cheque for the purpose of paying one of the instalments under the Loan Agreement which was rejected upon its presentation with the note '*Account Closed*'. A demand-cum-legal notice in accordance with Section 138 (*Dishonour of cheque for insufficiency, etc., of funds in the account*) of the NI Act was issued by the Respondent after the cheque was dishonoured, wherein the Respondent requested the Corporate Debtor as well as the Appellant to make the necessary payment of the debt that had been advanced. An acknowledgment was given on the part of the Corporate Debtor and the Appellant in respect to their responsibility to the obligation pertaining to the debt but no payments were made by them. Hence, the Respondent filed criminal proceedings under Section 190 (*Cognizance of offences by Magistrate*) of the Code of Criminal Procedure, 1973 ("**CrPC**") read with Sections 138, 141(*Offences by companies*) and 142 (*Cognizance of offences*) of the NI Act.

The Corporate Debtor was admitted into CIRP while the proceedings under NI Act were pending before the metropolitan magistrate ("**Magistrate**"), by the virtue of an application filed under Section 9 (*Application for initiation of corporate insolvency process by operational creditor*) of the IBC before the National Company Law Tribunal, Ahmedabad ("**NCLT**"). The NCLT admitted the said application and accordingly, the moratorium in terms of Section 14 (*Moratorium*) of the IBC came into effect.

Further, the Appellant filed an application for discharge with the Magistrate in the proceedings under the NI Act. However, the Magistrate denied the said application by an order dated November 1, 2019. Further, the Appellant approached the Delhi High Court ("**HC**") via a Criminal Revision Petition, which the HC dismissed. Thus, being aggrieved by the order of HC, the Appellant challenged the said order and preferred the present appeal before the SC.

Issue

Whether the proceedings under NI Act can continue during the pendency of the proceedings under IBC.

Arguments

Contentions of the Appellant:

As per the Appellant, the criminal proceedings under NI Act purports due to the failure of payment of debt. It was contended by the Appellant that basis of Section 138 proceedings stands eliminated in a situation wherein the debt itself gets vanished owing to the CIRP being admitted.

Additionally, the Appellant contended that the proceedings under Section 138 of NI Act's is primarily compensatory in character, but it includes a punitive element for the sole purpose of enforcing the compensation provisions.

According to the Appellant, his liability arises from his position as a managing director and authorised signatory of the Corporate Debtor since the debt was taken by the Corporate Debtor as a corporate loan. Therefore, once the proceedings against the Corporate Debtor have gone into abeyance under Section 14 of IBC, the liability of the Appellant also stands discharged.

Contentions of the Respondent:

The Respondent put forth the contention that that there would be no instance of the offence being compounded retroactively under Section 138 of the NI Act resulting from the resolution plan as the commencement of the CIRP took place later than the commencement of the criminal proceedings under the NI Act.

Further, according to the Respondent the restrictions imposed under IBC do not prevent the moving forward of the criminal proceedings against the Corporate Debtor, its directors, or its officials. A Corporate Debtor's criminal responsibility may be discharged if it is dissolved during the insolvency process but not its directors, or its officials.

Observations of the SC

The SC observed that Section 32A (*Liability for prior offences, etc.*) of IBC categorically discharges a Corporate Debtor of its pre-existing civil and criminal liabilities after the initiation of CIRP. However, it also states that the officials of Corporate Debtor having a direct or indirect role in commission of an offence prior to initiation of CIRP shall continue to be liable for prosecution for those offences. Consequently, the Appellant's liability under section 138 of NI act would not be discharged.

SC also noted that the NI Act and IBC are two fundamentally different legislations in respect to their scope and nature. Further, SC held that the actions taken against signatories or directors under the NI Act are not subject to the moratorium provided under Section 14 of the IBC. Additionally, the termination of debts extinguished under Section 31 or Sections 38 to 41 of the IBC would imply that the criminal proceedings also stand terminated.

SC relied upon the ***Shah Brothers Ispat Private Limited v. P. Mohan Raj and Others [Company Appeal (AT) Insolvency No. 306 of 2018]***, and held that the actions which are brought under the Section 138 of the NI Act are of a penal nature as it calls for a fine and imprisonment rather than money recovery. The proceedings under NI Act are not comparable to suit procedures or recovery proceedings because the accused may be subject to imprisonment or fine, or both. Therefore, the said procedure of insolvency is not the same as a suit case. Hence, the liability of Appellant as per the Section 138 of the NI Act is not discharged merely by an initiation of CIRP under IBC.

In a nutshell, the Appellant's participation in CIRP through the submission of its claim and membership in the committee of creditors for the purpose of approval of the resolution plan does not result in the compounding of the offence under Section 138 of the NI Act and hence, the Appellant is not discharged of his liability.

Decision of the SC

The SC held that the proceedings under IBC and NI Act would not intercede each other as they are quite different in their scope. The SC observed that the moratorium under Section 14 of the IBC does not apply to the proceedings initiated against signatories/directors under the NI Act. In the similar context, SC held that the extinguishment of debt under Section 31 or Sections 38 to 41 of the IBC would not *ipso facto* apply to the extinguishment of any criminal proceeding.

The SC held that the resolution plan must comply the laws which are in force and the laws in force cannot be controlled by the clauses contained in the resolution plan. For this, the SC referred to the Section 30(2)(e) of the IBC which requires that a resolution plan be approved only if it does not violate any provisions of the law for the time being in force. Therefore, the SC observed that: *"the clauses as contained in the resolution plan referred to above, only extinguishes the liability of the corporate debtor and not the natural persons."*

VA View:

The present judgement settles the question of the impact of subsequent insolvency of the defaulting company upon the pending criminal proceedings under the NI Act as well as the extent and continuation of the liability of directors of the said defaulting company. SC has rightly highlighted the distinct nature of the proceedings under IBC and NI Act, as a result of which, the criminal proceedings under NI Act does not vanish due to the extinguishment of debt under a CIRP proceeding under IBC.

In a nutshell, the judgment is a milestone which has addressed the issue keeping in consideration the spirit as well as the nature of the IBC as it preserves the rights of the creditors and the financial institution with respect to the recovery of debt.

II. Bombay High Court: A share purchase agreement containing option to sell the shares does not amount to derivative contract, thereby does not violate provisions of SCRA.

The Hon'ble Bombay High Court ("**High Court**") has, by the judgment pronounced on February 2, 2023, in the matter of ***Percept Finserve Private Limited v. Edelweiss Financial Services Limited [Commercial Appeal (L) No.284 0f 2019 in Commercial Arbitration Petition No. 220 of 2014]*** ("**Impugned Order**"), held that a contract containing put option for securities does not amount to derivative contract and hence, not prohibited under the Securities Contracts (Regulation) Act, 1956 ("**SCRA**").

Facts

Edelweiss Financial Services Limited ("**Respondent**") entered into a share purchase agreement dated

December 8, 2007 ("**SPA**") with Percept Finserve Private Limited ("**Appellant 1**") which was subsequently amended via a deed of rectification dated April 21, 2008 ("**Deed**") as well as an amendment agreement dated April 23, 2008 ("**Amendment Agreement**") through which 2,28,374 shares of Percept Limited ("**Appellant 2**") were purchased by the Respondent from Appellant 1 for a total consideration of INR 20 Crore.

The SPA had certain conditions subsequent setout therein, first of which required Appellant 1 to require Appellant 2 to accomplish restructuring of the entire group companies by December 31, 2007 and provide proof of completion of the restructuring to the Respondent.

A dispute was raised by the Respondent on the grounds that there was a failure/negligence on the part of Appellant 1 pertaining to the completion of the restructuring of the group companies within the period stipulated in the SPA, that is, December 31, 2007, and therefore, a breach of the SPA. Owing to the breach of SPA, Respondent was entitled to resell the shares of INR 20 Crore to Appellant 1 for an amount that would yield internal rate of return of 10% of the consideration paid to Appellant 1 under the SPA.

Thereafter, the parties entered into an Amendment Agreement whereby the Respondent extended the timeline for completion of the restructuring to June 30, 2008, failing which the Respondent was entitled to the following remedies as per clause 8.5 of SPA ("**Investor Rights Clause**"):

"8.5. In the event of non-fulfillment of the first Condition Subsequent, the Investor shall have the right to:
8.5.1. Re-sell the Shares held by it to the Seller or its Affiliates and the Seller is bound to purchase the same, at a price which would give the Investor an internal rate of return of 10% on the Purchase Consideration; or……
"

Appellant 1 failed to fulfill the conditions subsequent within the extended time period. Thereafter, the Respondent initiated arbitration proceeding and invoked the Investor Rights Clause and sought the remedies contained therein.

The sole arbitrator by an award dated June 6, 2013 rejected the Respondent's claim on the ground that transaction (specifically the Investor Rights Clause) was illegal/ unenforceable being in breach of SCRA. This gave an option to the Respondent to demand repurchase of the shares from Appellant 1 as it constituted forward contract which is prohibited under Section 16 (*Power to prohibit contracts in certain cases*) of SCRA as read with the circular by Securities and Exchange Board of India ("**SEBI**") dated March 1, 2000. Further, it was held that Investor Rights Clause was also illegal because it contains an option concerning future purchase of shares, thus a contract in derivatives and not being traded on a recognized stock exchange was illegal under Section 18A (*Exclusion of spot delivery contracts from sections 13, 14, 15 and 17*) of SCRA.

Aggrieved by the said award, Respondent filed an application under Section 34 (*Application for setting aside arbitral awards*) of Arbitration and Conciliation Act, 1996 ("**Act**"). The learned single judge overturned the arbitrator's conclusion, stating that the aforementioned Investor Rights Clause is entirely legal and does not contravene any of the provisions of SCRA. Hence, this appeal was filed under Section 37 (*Appealable orders*) of the Act.

Issue

Whether the Investor Rights Clause containing option to resell the shares amounts to derivative/future contract and thereby violates the provisions of SCRA.

Arguments

Submission made by the Appellants:

It was contended by the Appellants that the Investor Rights Clause being contract in derivatives attracted the rigors of Section 18A of SCRA, that is, such an option must be traded on a recognized stock exchange and settlement on the clearing house of the recognized stock exchange. Therefore, the clauses being in breach of Section 18A of SCRA were illegal and unenforceable. The option derived its value from the underlying shares of Appellant 2 and, therefore, was a derivative. A derivative in the present case, being an option attached to the shares of an unlisted public company, was not permitted, and would fall foul of the public policy under Section 18A of SCRA.

Further, the Appellants relied on SEBI notification dated October 3, 2013 issued under Section 16 of SCRA ("**Notification**") which *inter alia* permitted contracts in shareholders agreements or articles of association of group companies, for purchase or sale of securities pursuant to the exercise of an option contained therein to buy or sell the securities, on the terms and conditions set out therein. The Notification clarifies that option contracts as in the present case, entered prior to the date of the Notification attracted the rigors of Section 18A of SCRA and hence were prohibited and contravenes the provisions of SCRA.

Contentions raised by the Respondent:

The Respondent had put forth his contention that contract in derivatives or options contract are distinct from the contract between two shareholders containing an option to buy or sell the shares owned by them. The Respondent substantiated his argument by stating that this distinction between a contract in derivatives and a contract for sale or purchase of Securities, pursuant to the exercise of an option contained in a shareholders agreement, is also apparent from the Notification, according to which the contracts in derivatives are distinct and different from a contract for sale or purchase of securities pursuant to the exercise of an option contained in a shareholders agreement.

Further, the Respondent submitted that Section 18A of SCRA deals only with contracts in derivatives, that is, options contract, which can be traded, bought, sold and settled. Therefore, Section 18A of SCRA would not be applicable to a contract existing between two shareholders containing an option for sale or purchase of their own shares.

The Respondent relied on the judgment of the High Court in the case of ***Banyan Tree Growth Capital L.L.C. v. Axiom Cordages Limited and Others*** [***2020 SCC Online Bom 781***] and another judgement of the Calcutta High Court in the case of ***EIG (Mauritius) Limited v. McNally Bharat Engineering Company Limited [2021 SCC Online Cal 2915].***

Observations of the High Court

The High Court observed that a contract for sale or purchase of shares would come into being only at a future point of time. Further, as per the Investor Rights Clause, it is evident that there was no contract of sale or purchase of shares at a future date as of the day the SPA was signed. A contract that grants the buyer the right to demand that his vendor repurchase securities upon the occurrence of a certain contingency would only indicate that there was no obligation at the time the contract was signed and

that the obligation only developed as a result of the occurrence of the contingency. The contract would come into being, if at all, at a future point of time, after the satisfaction of the below mentioned two conditions:

(i) failure of condition subsequent attributable to Appellant 1; and
(ii) exercise of option by the Respondent to require repurchase of shares by Appellant 1 upon such failure.

Entering into a call or a put option for sale is not prohibited under the provisions of Section 18A of SCRA to be read with Section 16 of SCRA. However, it prohibits trading or dealing in such option by treating it as a security.

Decision of the High Court

The High Court while upholding the Impugned Order held that the contract cannot be termed as a trade or contract in derivatives if it merely contains a put in option pertaining to the securities. Therefore, having a put option concerning a security cannot be termed as illegal as per Section 18A of SCRA. The Investor Rights Clause is not contract for sale or purchase of securities, but merely an option which the promisee may exercise and further, such option does not amount to making of a contract in a derivative.

VA View:

The High Court in the instant case interpreted the term "derivative contract" by making it amply clear that each contract/agreement cannot be automatically termed as derivative contract/trade, merely because it contains a put option of securities.

It is pertinent to note that, unless such option is being traded by treating it as a "security" in contravention of Section 18A of SCRA, that is, traded otherwise than on a recognised stock exchange, the same is not in violation of SCRA.

From the above, it may be concluded that there is no bar to enter into shareholders' agreement which merely provides an option to either of the parties to interse purchase/ sell the shares.

III. NCLAT: Fraud for the purpose of Section 66 of the IBC includes a debt where the debtor has no intention to repay.

The National Company Law Appellate Tribunal, New Delhi ("**NCLAT**") has, in its judgement dated March 29, 2023 ("**Judgement**"), in the matter of ***Shri Baiju Trading and Investment Private Limited v. Mr. Arihant Nenawati and Others [Company Appeal (AT)(Ins.) No. 699 of 2021]***, held that 'fraud' for the purpose of Section 66 (*Fraudulent trading or wrongful trading*) of the Insolvency and Bankruptcy Code, 2016 ("**IBC**") would include debts which the debtor has no intention to repay or does not expect to be able to pay.

Facts

Royal Refinery Private Limited ("**Corporate Debtor**") was engaged in the business of trading in bullions, that is, import and export of gold and selling/ purchasing of gold in local markets. Raksha Bullion, a company that was doing business with the Corporate Debtor filed an application under

Section 9 *(Application for initiation of corporate insolvency resolution process by operational creditor)* of the IBC owing to the Corporate Debtor's default in payment of INR 4,90,01,183/- to Raksha Bullion. The National Company Law Tribunal, Mumbai ("**NCLT**") by way of its order dated November 13, 2019, initiated corporate insolvency resolution process ("**CIRP**") against the Corporate Debtor.

Shri Baiju Trading and Investment Private Limited ("**Appellant**") engaged in the business of non-banking financial services, had taken financial assistance of INR 41.03 Crores from the Corporate Debtor to overcome financial distress. The amount owed by the Appellant to the Corporate Debtor remained unpaid for over a year prior to commencement of CIRP against the Corporate Debtor and was subsequently written off from the books of accounts of the Corporate Debtor by the erstwhile directors of the Corporate Debtor; namely Mr. Vishal Choudhary ("**Respondent No. 2**") and Mr. Gaurav D. Panwar ("**Respondent No. 3**").

Mr. Nandkishor Vishnupant Deshpande, the resolution professional of the Corporate Debtor ("**RP**"), filed an application before the NCLT under Section 66 of the IBC read with Section 26 *(Application for avoidance of transactions not to affect proceedings)* of the IBC, alleging a fraudulent transaction between the Appellant and the Corporate Debtor involving the said amount of INR 41.03 Crores ("**Application**"). In this Application, the RP, amongst other things, pleaded the NCLT to direct the Appellant, Respondent No. 2 and Respondent No. 3 to make contributions to the assets of the Corporate Debtor. The NCLT by way of its order dated January 29, 2021 ("**Impugned Order**") allowed this Application and observed that the Appellant was the sole beneficiary of the fraudulent transaction.

Aggrieved by the Impugned Order, the Appellant filed the present appeal under Section 61 *(Appeals and Appellate Authority)* of the IBC ("**Appeal**").

The NCLT had also passed an order dated April 16, 2021, for liquidation of the Corporate Debtor, wherein Mr. Arihant Nenawati was appointed as the liquidator of the Corporate Debtor. In light of the said liquidation order passed by the NCLT, the RP of the Corporate Debtor had become '*functus officio'*, that is, his agency to serve as the RP of the Corporate Debtor had expired. Therefore, the NCLT by way of an order dated September 8, 2021, held that the appointed liquidator of the Corporate Debtor namely Mr. Arihant Nenawati ("**Respondent No. 1**") be substituted and impleaded in the Appeal, as '*Respondent No. 1*', in place of the RP.

Issue

Whether 'fraud' for the purpose of Section 66 of the IBC would consist of debts which the debtor has no intention to repay or does not expect to be able to pay.

Arguments

Contentions of the Appellant:

The Appellant contended that the Application was without any substance and that the NCLT had placed the Appellant in jeopardy by allowing such Application. The Appellant submitted that the Respondent No. 1 had failed to submit any supporting documentary evidence before the NCLT, which would establish that the transaction between the Appellant and the Corporate Debtor was fraudulent in nature. The Respondent No. 1 did not even support his claims by way of any additional evidence or investigation report like a forensic audit.

The Appellant submitted that it had availed financial assistance from the Corporate Debtor to merely overcome financial distress and that no transaction had taken place between the Appellant and the Corporate Debtor after May 16, 2018. The outstanding dues towards the Corporate Debtor were pending for more than one year, owing to the Appellant's financial problems being aggravated by the pandemic. It was also submitted that the Appellant and the Corporate Debtor were distinct corporate entities, carrying on different businesses and had no relationship with each other. The transaction was duly reflected in the books of accounts of both the parties as a borrowing transaction and should have been treated as a normal commercial transaction without any intent to defraud the creditors of the Corporate Debtor. The Appellant contended that no case of mala fide intention or willful misconduct including collusion with the Corporate Debtor had been established by the Respondent No. 1 and therefore, the NCLT had erred in allowing the Application.

The Appellant further contended that Section 66 of the IBC provides for three milestones which were required to be met before admission of an application. First, there should have been a clear 'opinion' followed by suitable 'determination' and finally there should have been a concrete 'finding'. These milestones had not been met and the parameters stipulated under Section 66 of the IBC were not established in the Application. Moreover, Regulation 35A (*Preferential and Other Transactions*) of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 ("**CIRP Regulations**") had not been complied with and no '*mens-rea'* was established. Therefore, the Impugned Order passed by the NCLT was illegal. In order to support its arguments, the Appellant relied on the judgements of ***Svenska Handels Bunken v. Indian Charge Chrome and Others [(1994) 1 SCC 504]*** and ***Anil Rishi v. Gurbaksh Singh [(2006) SCC 558]*** wherein the Hon'ble Supreme Court of India held that allegations of fraud are grave in nature and cannot be made on a mere suspicion and need to be pleaded with strong evidence.

The Appellant contended that Respondent No. 1 had classified the transaction between the Appellant and the Corporate Debtor as fraudulent purely on assumption basis. Further, mere write off by the Corporate Debtor of the debt of INR 41.03 Crores from its books of accounts would not harm the Corporate Debtor in any manner and that the Corporate Debtor continued to have its rights to recover the money from the Appellant, in accordance with the law.

Contentions of the Respondent No. 1:

The Respondent No. 1 vehemently opposed all the averments made by the Appellant as misleading, mischievous, devoid of any merit and pure abuse of the process of law and submitted that the Appeal filed should be dismissed.

The Respondent No. 1 submitted that the entire money owed by the Appellant to the Corporate Debtor was written off by Respondent No. 2 and Respondent No. 3 way of a simple journal entry '*Sundry Balances W/off*', just one month prior to the Corporate Debtor being raided by the Department of Revenue Intelligence. Respondent No. 1 submitted that this transaction was fraudulent in nature and made in connivance between the Appellant, the Respondent No. 2 and the Respondent No. 3, by manipulating ledgers of the Appellant and the Corporate Debtor, in order to reap the illegal benefits arising from the write off of INR 41.03 Crores. In Respondent No. 1's view, the transaction was carried out with clear knowledge of all concerned and with the intent to defraud the creditors of the Corporate Debtor. Further, the alleged loan of INR 41.03 Crores was given to the Appellant even though the Corporate Debtor was merely functioning as a gold bullion trader and was not in the business of lending

money. Therefore, such a huge amount should not be written off without any reasons and cannot be treated anything less than a fraudulent and sham transaction.

The Respondent No. 1 also relied on the Impugned Order wherein the NCLT held that the IBC does not require pre-existence of '*mens rea'* in order to establish a fraudulent transaction and also denied the contention of the Appellant that Regulation 35A of the CIRP Regulations were not complied with.

The Respondent No. 1 placed reliance on ***Ram Preeti Yadav v. U.P. Board of High School and Intermediate Education [(2003) 8 SCC 311]*** ("**Ram Preeti Yadav Case**"), wherein the Hon'ble Supreme Court of India held that a sole beneficiary of the fraud must be presumed to be a party to the fraud.

Lastly, the Respondent No. 1 contended that the Appellant was in no position to be aggrieved by the Impugned Order which effectively directed the Appellant to make contributions of the monies owed by it towards the assets of the Corporate Debtor which would assist in the process of liquidation by increasing the pool of assets available for liquidation thereby benefitting all stakeholders of the Corporate Debtor. Hence, the Respondent No. 1 sought for dismissal of the Appeal.

Contentions of Respondent No. 2 and Respondent No. 3:

Respondent No. 2 and Respondent No. 3 submitted that all transactions taking place between the Corporate Debtor and the Appellant were official transactions and had been confirmed by both the parties. Hence, the question of such transactions being classified as fraudulent did not arise. The Application was not supported by any verifiable evidence and was based on assumptions and presumptions. They further submitted that the Appellant had informed them about its inability to refund the balance amount as it was under financial stress. Consequently, the Corporate Debtor had written off the balance in its books of accounts believing that the amount, if received in the future, will be considered as profit of the Corporate Debtor. The transaction was entered into in good faith during the ordinary course of business as evidenced by the audited financial reports of the Corporate Debtor for the financial year 2017-2018. Therefore, the said transaction would not fall within the purview of Section 66 of the IBC.

Observations of the NCLAT

The NCLAT observed that the NCLT is empowered under Section 66 of the IBC to direct a person to make contributions to the corporate debtor's assets, in case such person has carried on the business of the corporate debtor with intention to defraud its creditors. The NCLAT interpreted that 'fraud' can, *inter alia*, consist of such debts which the debtor has no intention of paying or does not expect to be able to pay or such fraud may also happen by way of a false representation to pay back when there is no intention to do so. Furthermore, the expression 'any person' would include a knowing party to the carrying out of the fraudulent transaction.

The NCLAT observed that Regulation 35A of the CIRP Regulations require the resolution professional to form an opinion on whether the corporate debtor has been subjected to any transaction covered under Sections 43 *(Preferential transactions and relevant time),* 45 *(Avoidance of undervalued transactions),* 50 *(Extortionate credit transactions)* and 66 of the IBC and where such opinion has been formed, the resolution professional can make a determination and is subsequently required to apply to the adjudicating authority for appropriate relief. The Corporate Debtor lending an amount of INR 41.03

Crores to the Appellant and the Appellant benefitting of this amount was unusual in the eyes of the NCLAT. Further, the Corporate Debtor was in no way connected with the business of financial services or lending money. The NCLAT observed that in the gold business, it's a standard practice for transactions and dealings to occur on spot payment basis and there is hardly any scope for lending money in such businesses. In fact, the bullion business is conducted on thin margins and the cash flow of such business is required to be maintained in order for such businesses to sustain. Furthermore, there was no reason for the Corporate Debtor to give such loan without any substance and that too without suitable incentives or returns for time value of money.

The NCLAT observed that there was no explanation as to why such a write off was necessary and what circumstances led to it. Such transactions without any security interest or bank guarantee as collateral security in favour of the Corporate Debtor and the subsequent writing off of the same can only be termed as a fraudulent transaction done with the intent to defraud the creditors of the Corporate Debtor and evidently the Appellant was the principal beneficiary of such transaction.

Decision of the NCLAT

The NCLAT agreed with the observations made by the NCLT in the Impugned Order and held that the nature of the transaction in the instant case would squarely come within the ambit of Section 66 of the IBC. The NCLAT reiterated the settled principle of law laid down in the Ram Preeti Yadav Case that a beneficiary of fraud is presumed to be a party to the fraud. Further, the NCLAT observed that the Appellant had taken contrary stands before the NCLT while explaining the nature of the transaction and opined that such contradictory statements raised doubts in the mind of the NCLAT regarding the real nature of the transaction and relationship between the Appellant and the Corporate Debtor.

Therefore, the Appeal was dismissed by the NCLAT due to being devoid of any merit.

VA View:

It is the duty of a liquidator or the resolution professional to correct and reverse any fraudulent or wrongful transaction in case it is found that any person has carried on the business of the corporate debtor with the intent to defraud its creditors.

The NCLAT, while affirming the decision given by the NCLT, held that the Appellant was the principal beneficiary of fraudulent and wrongful trading and therefore, rightly classified the transaction to be fraudulent under Section 66 of the IBC. The NCLAT, through this Judgement, has thrown light on the fact that 'fraud' can, *inter alia*, consist of money lent by a corporate debtor which the corporate debtor has no intent of receiving back. Further, the NCLAT also reemphasized the position of law laid down in the Ram Preeti Yadav Case that the beneficiaries of fraud must be presumed to be a party to the fraud as well. Therefore, 'fraud' for the purpose of Section 66 of the IBC would consist of debts which the debtor has no intention to repay or does not expect to be able to pay.

IV. NCLAT: IBC does not contemplate multiplicity of applications against the same personal guarantor.

The National Company Law Appellate Tribunal, Chennai ("**NCLAT**"), by a judgment pronounced on March 29, 2023, in the matter of ***Union Bank of India v. Mr. P. K. Balasubramanian [Company Appeal (AT) (CH) (Ins) No. 293 of 2022]*** has held that the Insolvency and Bankruptcy Code, 2016 ("**IBC**") does not contemplate multiplicity of applications against the same personal guarantor.

Facts

Union Bank of India ("**Appellant**") had filed an application under Section 95 (*Application by creditor to initiate insolvency resolution process*) of the IBC, before the National Company Law Tribunal, Chennai (Bench – I) ("**NCLT**"), thereby seeking initiation of insolvency resolution process against the Mr. P. K. Balasubramanian ("**Respondent**"), in the capacity of personal guarantor of Tebma Shipyard Limited ("**Principal Borrower**"). The aforesaid application was filed by the Appellant on December 31, 2021 and the same was assigned a registration number by the NCLT registry on February 9, 2022.

State Bank of India ("**SBI**") had also filed an application before the NCLT under Section 95 of the IBC, seeking initiation of insolvency resolution process against the Respondent on January 3, 2022, that is, three days after filing of the above-mentioned application against the Respondent by the Appellant. The aforesaid application filed by SBI was assigned a registration number by the NCLT registry on January 12, 2022, that is, earlier in point of time as against the application filed by the Appellant.

The application filed by the Appellant was listed before the NCLT on March 4, 2022, May 1, 2022, May 2, 2022 and June 7, 2022. However, on June 7, 2022, the application filed by SBI was listed relatively higher on board in the cause list issued by the NCLT as against the application filed by the Appellant. In the virtual hearing on June 7, 2022, the application filed by SBI was heard first and the NCLT passed an order appointing an interim resolution professional in respect of the Respondent, so as to examine the application filed by SBI and submit a report for recommending acceptance or rejection of the aforesaid application in the report, within a period of ten (10) days, as envisaged under Section 99(1) (*Submission of report by resolution professional*) of the IBC. In view of an interim resolution professional having already been appointed in the application filed by SBI, when the application filed by the Appellant was subsequently taken up, the NCLT dismissed the application filed by the Appellant.

Aggrieved by the aforesaid order dated June 7, 2022, whereby the NCLT dismissed the application filed by the Appellant ("**Impugned Order**"), the Appellant preferred an appeal before the NCLAT. In the meanwhile, the interim resolution professional submitted a report dated July 2, 2022 with recommendation to initiate the insolvency resolution process in respect of the Respondent. However, the Respondent subsequently withdrew his appeal before the NCLAT, with liberty to raise all factual and legal contentions on merits of the case, before the NCLT, prior to passing of the final order of initiation of insolvency resolution process of the Respondent by the NCLT.

Issue

Whether the IBC contemplates multiplicity of applications against the same personal guarantor.

Arguments

Contentions raised by the Appellant:

The Appellant contended that the NCLT proceeded with appointment of insolvency resolution

professional in the application filed by SBI, treating the application filed by SBI as an earlier application and thereby ignoring the fact that the application under Section 95 of the IBC was filed by the Appellant at a prior point in time as against filing of a similar application by SBI.

The Appellant further submitted that the NCLT registry was at fault by assigning registration number to the application filed by SBI earlier in point of time (January 12, 2022) as against assigning registration number to the application filed by the Appellant (February 9, 2022), whereas, in fact, the Appellant had filed the application against the Respondent earlier in point of time (December 31, 2021) as compared to SBI (January 3, 2022).

Further, the Appellant placed reliance on judgment delivered by the Supreme Court in the matter of ***Vidyawati Gupta and Others v. Bhakti Hari Nayak [(2006) AIR SCW 813]*** and a three-judge bench judgment delivered by the National Company Law Appellate Tribunal, New Delhi in the matter of ***Krishan Kumar Basia v. State Bank of India [Company Appeal (AT) (Ins) No. 721 of 2022]*** to substantiate its contention that the expression 'filing' and 'date of application' could be interpreted to mean the date of filing of an 'application' manually and electronically and allotting of number electronically and not the date of numbering by the registry finding it to be defect free.

Contentions raised by the Respondent:

It was submitted on behalf of SBI that the Appellant did not challenge the order dated June 7, 2022 passed by the NCLT in the application filed by SBI. Further, the interim resolution professional had already submitted its report in terms of Section 99 of the IBC and the NCLT would pass order in due course for admission or rejection of the application filed by SBI, as the case may be.

It was further submitted that the 'date of application' is nowhere contemplated in the IBC and it would imply that, the application should be defect free and eligible to be taken on record by the NCLT. Hence, it cannot be said that 'interim moratorium' ought to have commenced from the 'date of filing' of a defective application.

Observations of the NCLAT

It was observed that by Impugned Order passed on June 7, 2022, the NCLT had appointed an interim resolution professional, directing him to submit a report recommending for acceptance or rejection of the application filed by SBI; however, the NCLT has not admitted or rejected the aforesaid application.

Thereafter, the NCLAT analysed the applicable provision of the IBC dealing with insolvency resolution process in respect of a personal guarantor, including Sections 96 (*Interim-moratorium*), 97 (*Appointment of resolution professional*), 99 and 100 (*Appointment of resolution professional*) of the IBC.

Further, the NCLAT observed that one of the arguments raised by the Appellant is that since the application against the Respondent was filed by the Appellant, three days earlier in point of time, as compared to the date of filing of application by SBI; the application filed by the Appellant ought to have been admitted first.

However, the NCLAT observed that no prejudice has been caused to the Appellant, since in terms of Section 103 (*Registering of claims by creditors*) of the IBC, all creditors including the Appellant can file their claims with the resolution professional, upon admission of the insolvency resolution process

against the Respondent.

The NCLAT also observed that even though both the respective legal counsels, appearing on behalf of the Appellant and the Respondent were present when the Impugned Order was passed, however, none pointed out to the NCLT that the application against Respondent was filed by the Appellant, three days earlier in point of time, as compared to the date of filing of application by SBI.

Further, the NCLAT analysed the judgment delivered by the National Company Law Appellate Tribunal, New Delhi in the matter of ***Dinesh Kumar Basia v. State Bank of India [Company Appeal (AT) (Ins) No. 724 of 2022]***, whereby it was concluded that even if there is any defect in the application, which is subsequently cured, the date of presentation of the application shall remain the same and shall not depend upon the date when defects are cured. In view of the afore-mentioned ratio laid down, in the present case, the NCLAT observed that it is the 'date of filing' of the 'application' under Section 95 of the IBC to be taken into consideration, and not the date when the 'application' is numbered.

However, in the present case, when the application filed by the Appellant was taken up for hearing on March 4, 2022, April 1, 2022, May 2, 2022 and June 7, 2022, it was never brought to the notice of the NCLT, that SBI had also filed an application under Section 95 of the IBC, three days later than the application filed by the Appellant. Hence, the Appellant cannot raise a contention that it had no opportunity to the apprise the NCLT about the afore-mentioned, particularly on June 7, 2022, whereby both the applications filed by the Appellant and SBI were listed on the same day, and when the application filed by SBI was taken up first, the NCLT passed an order appointing the interim resolution professional.

Further, the NCLAT observed that Section 96(1)(a) of the IBC provides that an interim moratorium shall commence on the date of the 'application' in relation to all the debts. Further, as per Section 96(1)(b) of the IBC, during the course of the interim moratorium: (i) any legal action or proceeding pending in respect of any 'debt' shall be deemed to have been stayed; and (ii) the 'creditors of the debtor' shall not initiate any legal action or proceedings in respect of any 'debt'. In this regard, the NCLAT observed that the expression 'creditors of the debtor' implies all other 'creditors of the debtor', apart from the 'creditor', on whose 'application' 'interim moratorium' had commenced. Further, once 'application' under Section 100 of the IBC is admitted, 'moratorium' commences with respect to all 'debts' under Section 101 (*Moratorium*) of the IBC and thereafter 'public notice' is issued and 'claims' from 'creditors' are invited under Section 102 (*Public notice and claims from creditors*) of the IBC. Further, as per Section 103 of the IBC, all creditors can file their respective claims before the resolution professional appointed in respect of personal guarantor, which addresses the concern of the Appellant, and hence, no prejudice would be caused to the Appellant. Hence, when an 'insolvency resolution process' commences against the 'personal guarantor', all 'creditors' of the 'personal guarantor' are taken care of. Therefore, the IBC does not contemplate multiplicity of 'applications' against the same 'personal guarantor'.

Decision of the NCLAT

In view of the fact that the NCLT has not yet admitted the application filed by SBI and more pertinently, no prejudice would be caused to the Appellant by virtue of Section 103 of the IBC, the NCLAT dismissed the appeal without imposing any costs.

VA View:

Considering that there are multiple applications being filed against the same personal guarantor across various benches of the National Company Law Tribunal throughout India, the jurisprudence in relation to the provisions pertaining to insolvency resolution against personal guarantor of a corporate debtor is still evolving with time; this judgment provides a much-needed practical clarity and puts this issue to rest that there cannot be multiple applications going on against the same personal guarantor.

Further, while addressing the above-mentioned legal issue, the National Company Law Appellate Tribunal has explained the legislative intent behind enacting Section 103 of the Insolvency and Bankruptcy Code, 2016, by virtue of which all creditors are entitled to file their respective claims before the resolution professional appointed to conduct the insolvency resolution process of the personal guarantor of the corporate debtor, and as such, there is no requirement to file and continue to adjudicate multiple applications against the same personal guarantor.

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