VAISH ASSOCIATES ADVOCATES ESTD. 1971

Between the lines...

A BRIEFING ON LEGAL MATTERS OF CURRENT INTEREST

KEY HIGHLIGHTS

* **Delhi HC:** Claims settled under a resolution plan become non-arbitrable and a reference of those claims would amount to reopening of the resolution plan.

* **Delhi HC:** Transfer of liabilities from a previous loan agreement makes the arbitration clauses in subsequent agreements, binding.

* **NCLAT:** No bar on the initiation of CIRP, if default is committed prior to Section 10A Period and continues during the Section 10A Period.

* **Gujarat HC:** Purchaser of an asset in a liquidation process is not liable for payment of government dues which were not substantiated adequately in the CIRP and not lodged with the liquidator.

I. Delhi HC: Claims settled under a resolution plan become non-arbitrable and a reference of those claims would amount to reopening of the resolution plan.

The Delhi High Court ("**Delhi HC**") has, in its judgement dated October 10, 2023, in the matter of ***Indian Oil Corporation Limited v. Arcelor Mittal Nippon Steel India Limited [ARB.P. 102/2022]***, held that claims that have already been settled under a resolution plan would become non-arbitrable once the resolution plan is approved by the committee of creditors ("**CoC**") and affirmed by the adjudication authority under the Insolvency and Bankruptcy Code, 2016 ("**IBC**").

Facts

Indian Oil Corporation Limited ("**Petitioner**") and Essar Steel India Limited ("**ESIL**"), formerly known as Essar Steel Limited, had entered into a gas supply agreement dated January 15, 2009 ("**GSA**"). Article 14 of the GSA empowered the Petitioner to call upon ESIL to take remedial steps for payment in the event of ESIL's failure to lift the entire adjusted annual contract quantity. On May 4, 2016, the Petitioner served a notice on ESIL in pursuance of the 'take or pay' obligation enumerated under Article 14 of the GSA for ESIL's failure to comply with its obligations thereunder. Consequently, ESIL served a termination notice on the Petitioner, which was disputed by the Petitioner on the ground that the Petitioner had not committed any breach of its contractual obligations under the GSA.

Thereafter, the Petitioner issued a demand notice dated April 27, 2017, on ESIL, towards recovery of the payments that were due to it, and upon non-receipt of such payments, the Petitioner subsequently issued a notice of dispute dated May 8, 2017, on ESIL. The Petitioner, in its notice of dispute, called upon ESIL to amicably resolve the dispute as contemplated under the GSA, but, since ESIL failed to respond to such notice, the Petitioner invoked arbitration under the provisions of the GSA.

However, during the pendency of the aforementioned dispute, corporate insolvency resolution process ("**CIRP**") was initiated against ESIL and a resolution professional ("**RP**") was appointed. While responding to the Petitioner's notice invoking arbitration, ESIL, in its letter dated August 7, 2017, apprised the Petitioner of the commencement of CIRP and the moratorium as declared by the National Company Law Tribunal, Ahmedabad ("**NCLT**"). The RP issued public notices inviting claims against ESIL and consequently, the Petitioner filed a claim for INR 3762,58,74,503. However, the RP *vide* his e-mail dated December 7, 2018, addressed to the Petitioner admitted the Petitioner's claim for a notional amount of INR 1 to ensure the Petitioner's participation in the CIRP and clarified that the balance claim amount was not admitted owing to the pending dispute between the Petitioner and ESIL.

The resolution plan submitted by Arcelor Mittal Nippon Steel India Limited ("**Respondent**") was approved by the CoC on October 25, 2018 ("**Resolution Plan**"). NCLT, while according its sanction to the Resolution Plan did not agree with the view of the RP to admit claims of the Petitioner at a notional value of INR 1 and directed the RP to include the claims of operational creditors including the Petitioner in the said Resolution Plan. The RP preferred an appeal before the National Company Law Appellate Tribunal ("**NCLAT**") against the decision of the NCLT. However, the NCLAT affirmed NCLT's view and modified the Resolution Plan to include therein certain claims, such as that of the Petitioner.

Against the order passed by the NCLAT, an appeal was preferred before the Hon'ble Supreme Court ("**SC**") in the case of ***Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta and Others [(2020) 8 SCC 531]*** ("**Essar Steel India Case**"), wherein the SC set aside the directions of both

NCLT and NCLAT in relation to inclusion of claims after the approval of the resolution plan. The SC explained the importance of the clean slate doctrine and held that once a resolution plan has been approved and accepted, the successful resolution applicant cannot be burdened with additional claims by modifying the resolution plan. The SC's decision affirmed the action of the RP and conferred a seal of finality on the Resolution Plan. Hence, the Respondent, as a successful resolution applicant, acquired 100% shareholding of ESIL and took over its management.

Thereafter, the Petitioner issued a notice of demand, calling upon the Respondent to pay the amounts that were due to the Petitioner under the GSA, however, the Respondent denied any liability arising from the GSA. This led to the Petitioner invoking arbitration against the Respondent, and upon the failure of the Petitioner and the Respondent to mutually appoint an arbitrator, the Petitioner approached the Delhi HC for the appointment of an arbitrator under Section 11 (*Appointment of arbitrators*) of the Arbitration and Conciliation Act, 1996 ("**Act**").

Issues

1. Whether the approval of the Resolution Plan resulted in an extinguishment of all the claims the Petitioner could enforce against the Respondent.

2. Whether the approval of the Resolution Plan would render disputes that were sought to be referred for arbitral tribunal's consideration, as non-arbitrable.

Arguments

Contentions of the Petitioner:

The Petitioner submitted that the admission of claims at a notional amount of INR 1 and the approval of the Resolution Plan could not have been viewed as a conclusive adjudication of the Petitioner's claims as flowing from the GSA, and therefore the Delhi HC ought to take appropriate steps for the constitution of an arbitral tribunal in order to resolve the dispute between the Petitioner and the Respondent. The Petitioner further contended that the 'take or pay' obligations under Article 14 of the GSA were to continue up to the year 2028 and would thus go far beyond the date on which the Resolution Plan was approved by the NCLT. Furthermore, SC's approval of the Resolution Plan with the Petitioner's claim being admitted at a notional value of INR 1 could not have been read as depriving the right of the Petitioner to raise claims which otherwise arose out of the GSA.

The Petitioner contended that the GSA was a continuing contract and the liabilities arising therefrom was a cause of action continuing to subsist irrespective of the closure of proceedings under IBC. Thus, the Petitioner was justified in approaching the Delhi HC to exercise the jurisdiction conferred upon the Delhi HC under Section 11 of the Act.

Contentions of the Respondent:

The Respondent contended that the concept of extinguishment of claims would not only have to be considered in the light of the principles laid out by the SC in the Essar Steel India Case but also in light of the express language of the Resolution Plan itself, which provided for the extinguishment and discharge of all liabilities and claims in relation to any corporate guarantees, indemnities and all other

forms of credit support provided by ESIL prior to the Resolution Plan approval date, upon the approval of the Resolution Plan.

The Respondent submitted that the SC in Essar Steel India Case had, in unequivocal terms, set aside the judgements of NCLT and NCLAT which had purported to revive the claims of the operational creditors such as the Petitioner, and negate the admission of claims at a notional value of INR 1 by the RP. Therefore, with the approval of Resolution Plan, the adjudication on the claims stood at finality and there could be no further adjudication on those claims. To support its argument, the Respondent relied on the case of ***Ghanashyam Mishra and Sons Private Limited v. Edelweiss Asset Reconstruction Company Limited [(2021) 9 SCC 657]*** ("**Ghanashyam Mishra Case**"), wherein the SC held that "*The legislative intent behind this is to freeze all the claims so that the resolution applicant starts on a clean slate and is not flung with any surprise claims. If that is permitted, the very calculations on the basis of which the resolution applicant submits its plans would go haywire and the plan would be unworkable.*"

Hence, the referral of the dispute to the arbitral tribunal would amount to a reopening of the Resolution Plan which would not only be wholly impermissible but would also amount to overriding the SC's pronouncement in the Essar Steel India Case.

The Respondent, bearing in mind the legal position that emerged from the Ghanashyam Mishra Case, concluded its arguments by submitting that the petition filed by the Petitioner under Section 11 of the Act was liable to be dismissed even if one employed the 'eye of needle' test, as laid down in the case of ***NTPC Limited v. SPML Infra Limited [(2023) SCC OnLine 389]*** ("**NTPC Limited Case**"), extracts of which have been reproduced below:

*"**Eye of the Needle:** …the pre-referral jurisdiction of the courts under Section 11(6) of the Act is very narrow and inheres two inquiries. The primary inquiry is about the existence and the validity of an arbitration agreement, which also includes an inquiry as to the parties to the agreement and the applicant's privity to the said agreement…The secondary inquiry that may arise at the reference stage itself is with respect to the non-arbitrability of the dispute. The limited scrutiny, through the eye of the needle, is necessary and compelling. It is intertwined with the duty of the referral court to protect the parties from being forced to arbitrate when the matter is demonstrably non-arbitrable.*"

Hence, the claims that were part of the Resolution Plan became non-arbitrable after such plan was approved by the NCLT.

Observations of the Delhi HC

While deciding on the issue on whether the approval of the Resolution Plan resulted in an extinguishment of existing claims, the Delhi HC observed that once a resolution plan is approved by the CoC and the adjudicating authority, it results in the extinguishment of all the existing claims that any party may have against the corporate debtor and no fresh adjudication can take place for any claim that was made part of the resolution plan. Relying on the Ghanashyam Mishra Case, the Delhi HC observed that the underlying theme noticed by the SC in the said case was the recognition of the right of a successful resolution applicant to take over a corporate debtor on a 'clean' or 'fresh slate', without being burdened by any uncertainties or a specter of irresolution. The approval of a resolution plan is statutorily recognized as a closure to all claims that persons or entities may have against a corporate debtor, and therefore, no fresh claims could be laid or enforced against the successful resolution applicant after the approval of a resolution plan. The Delhi HC observed that the successful resolution

applicant cannot be left open to defend or oppose claims which have not been factored in the resolution plan.

The Delhi HC further observed that IBC and the resolution process does not contemplate matters being left inchoate, in fact, it exhorts one to accept the seal of finality and quietude which stands attached to the approval of a resolution plan.

With respect to the question on whether the dispute mentioned in the petition filed by the Petitioner could be said to fall within the ambit of 'non-arbitrability', the Delhi HC relied on the NTPC Limited Case where it was observed that a refusal to refer parties to arbitration would be justified when there was 'not even a vestige of doubt' with respect to non-arbitrability or where it was evident that the matter was 'demonstrably non-arbitrable'. Hence, in Delhi HC's view, once it was accepted that the approval of the Resolution Plan results in the extinguishment of all claims that the Petitioner may have had, the dispute cannot be permitted to be urged again before the arbitral tribunal since it would amount to rewriting upon the clean slate and reopening of the Resolution Plan which would be impermissible in light of the finality accorded by the SC's decision in the Essar Steel India Case. Moreover, empowering the arbitral tribunal to adjudicate or rule upon such disputes would be contrary to the principles enunciated by the SC in the Ghanashyam Mishra Case.

Decision of the Delhi HC

In view of the entirety of the above, the Delhi HC dismissed the petition filed under Section 11 of the Act and held that once a resolution plan is approved by the CoC and the adjudicating authority, it amounts to extinguishment of all the existing claims that parties may have against the corporate debtor and no fresh claims could be laid or enforced against the successful resolution applicant after the approval of a resolution plan.

Further, the Delhi HC applied the 'eye of the needle' test enshrined in the NTPC Limited Case and opined that the disputes mentioned in the petition filed by the Petitioner were non-arbitrable and no reference to the arbitral tribunal was warranted.

VA View: Through this judgement, the Delhi HC has rightly emphasized on the clean slate doctrine laid down in the Essar Steel India Case wherein the SC held that a successful resolution applicant cannot suddenly be faced with undecided claims after the resolution plan submitted by it has been accepted, as this would amount to a hydra head popping up which would throw into uncertainty, amounts payable by a prospective resolution applicant who would successfully take over the business of the corporate debtor.

The legislative intent of IBC is to enable the successful resolution applicant to take over a corporate debtor on a clean slate and not be burdened by unforeseen liabilities, especially those that are neither factored in nor admitted in the resolution plan. Therefore, once a resolution plan receives assent by the CoC and the adjudicating authority, it results in the extinguishment of all the existing claims that any party may have against the corporate debtor and no fresh adjudication can take place for any claim that was made part of the resolution plan.

II. Delhi HC: Transfer of liabilities from a previous loan agreement makes the arbitration clauses in subsequent agreements, binding.

The Division Bench of High Court of Delhi ("**Delhi HC**"), *vide* its judgment pronounced on September 13, 2023, in the matter of ***DD Global Capital Private Limited and Others v. S.E. Investments Limited [FAO (OS) (COMM) 33/2018 and CM APPL. 7434/2018]***, has dismissed an appeal assailing the impugned judgment dated September 20, 2017 passed by the Single Bench of Delhi HC and held that transfer of liabilities from a previous loan agreement makes the arbitration clauses in subsequent agreements binding.

Facts

DD Global Capital Private Limited ("**DD Global/ Appellant No. 1**") approached S.E. Investments Limited ("**Respondent**") to avail a loan facility to the tune of INR 4 crores. Pursuant thereto, loan amount of INR 3.20 crores was sanctioned and disbursed in favour of DD Global in July, 2008, which was supposed to be repaid by July 7, 2009 along with interest thereon at the rate of 25% per annum. The aforesaid loan was secured by Appellant Nos. 2 and 3. Also, a piece of land admeasuring around 5.92 acres and situated at Zirakpur, Punjab owned by Renaissance Buildcon Company Private Limited ("**RBCL**") was mortgaged in favour of the Respondent to secure the loan disbursed to DD Global. Additionally, RBCL also extended a corporate guarantee in favour of the Respondent towards securing the loan.

However, DD Global failed to repay the loan amount of INR 3.20 crores together with interest. In view thereof, the Respondent agreed to restructure the previous loan. Accordingly, as on July 31, 2010, entire loan amount inclusive of applicable interest was amounting to INR 6.37 crores. There was re-financing of loan on July 31, 2010 by the Respondent to the tune of INR 9.10 crores by way of executing 5 new loan agreements for 1 year duration each at the rate of interest thereon being 30% per annum.

The afore-mentioned re-financed loan agreement was to be repaid within a year and the same was secured by personal guarantees extended by Appellant Nos. 2 and 3, corporate guarantee extended by RBCL and collateral of the mortgaged land belonging to RBCL situated at Zirakpur, Punjab. In addition to the afore-mentioned, the Appellants also executed undertakings/ declaration dated July 31, 2010 and 5 debit vouchers dated July 31, 2010 aggregating to INR 9.10 crores. Also, the Appellants issued post-dated cheques amounting to INR 9.10 crores.

However, in view of default on part of DD Global in repayment of the loan facilities, the Respondent invoked arbitration proceeding as stipulated under Clause 20 of the 5 loan agreements by issuing a common invocation letter dated September 25, 2012. Considering that the aforesaid 5 loan agreements formed part of the same transaction, common arbitration proceeding was initiated by the learned Arbitrator.

Thereafter, the learned Arbitrator passed an award dated June 22, 2016 and held that the Respondent herein is entitled to recover INR 9.10 crores as on July 31, 2010 jointly and severally from Appellants, along with interest for pre-award period and future interest at the rate of 18% per annum.

Pursuant thereto, the Appellants herein approached the Single Bench of Delhi HC seeking to set aside the aforesaid arbitral award under Section 34 of the Arbitration and Conciliation Act, 1996 ("**Arbitration Act**"). However, the same was dismissed by the learned Single Judge of Delhi HC *vide*

the impugned order, leading to filing of the present appeal before the Division Bench of Delhi HC by the Appellants.

Issue

Whether an arbitration clause stipulated in the subsequent agreement wherein liabilities stand transferred from the original agreement to a subsequent agreement, will be binding to invoke arbitration proceeding in respect of the original agreement even if the original agreement had no stipulation of arbitration clause.

Arguments

Contentions of the Appellants:

It was submitted that no amounts were disbursed by the Respondent pursuant to loan agreements executed in 2010 and that the Respondent has failed to produce any document to prove the same.

It was further contended that the loan agreements executed in 2008 and 2010 are totally separate and independent from one another. Further, the loan agreement executed in 2008 did not have an arbitration clause and the loan agreements executed in 2010 did not have any reference of the loan agreement executed in 2008. In view thereof, the learned Arbitrator could not have assumed jurisdiction on the matter arising out of loan agreement executed in 2008. Further, arbitration proceedings were invoked only under the aforesaid 5 loan agreements executed on July 31, 2010.

It was further submitted that Appellant had signed blank debit vouchers along with loan agreements executed in 2010. However, as the loan agreements executed in 2010 under which debit vouchers were signed by the Appellants do not make any reference to the loan agreement executed in 2008, as such, debit vouchers could not have been used to repay the monies outstanding under the loan agreement executed in 2008.

Further, the Appellants raised the issue of limitation and contended that claims under the loan agreement executed in 2008 is barred by limitation. The Appellants submitted that the aforesaid contention was raised before the learned Arbitrator as well, however, it was rejected.

Furthermore, the Appellant submitted that in the present case, Respondent had unilaterally appointed the learned Arbitrator. Pursuant to the Arbitration and Conciliation (Amendment) Act, 2015, a party interested in the outcome of arbitration proceeding has no unilateral right to appoint an arbitrator. Notably, the arbitral award in the present case was passed on June 22, 2016, at which point in time, the aforesaid amendment was already introduced. As such, the arbitral award ought to be set aside on this ground alone.

Contentions of the Respondent:

It was submitted on behalf of the Respondent that the arbitral award passed by the learned Arbitrator and the impugned judgment pronounced by the Single Bench of Delhi HC were good in law and need not be set aside.

Observations of the Delhi HC

Delhi HC refused to accept the contention raised by the Appellants that the 5 debit vouchers signed by them were blank and that the 5 loan agreements dated July 31, 2010 are null and void as no amounts were disbursed under the 2010 loan. Delhi HC observed that there is a clear finding by the learned Arbitrator, which has been upheld by the learned Single Judge that the 5 loans agreements dated July 31, 2010 were executed along with other documents as part of re-structuring of the previous loan extended to DD Global on July 3, 2008, which DD Global failed to repay. Consequently, parties had to enter into the aforesaid 5 loan agreements so as to grant a further period up to July 31, 2011. Therefore, such contention raised by the Appellants cannot be accepted.

Delhi HC further observed that the Appellants had admitted to execution of the 5 debit vouchers. In so far as the contention of the Appellants that the debit notes were blank at the time of their execution and were filled up at a subsequent point in time, it was observed that the Appellants have failed to prove the same and there is a clear finding by learned Arbitrator that except for bald statement made by the Appellants, no oral or documentary evidence has been placed on record.

It was further observed that the Appellants did not dispute or challenge the execution and validity of the 5 loan agreements dated July 31, 2010 at any point in time. Further, Delhi HC observed that the learned Arbitrator had rightly held that the 5 debit vouchers dated July 31, 2010 bears reference to adjustment of the original loan availed by DD Global in 2008 and its link to the subsequent loan availed in 2010. Further, it was observed that from the aforesaid debit vouchers, it is clear that the consideration against the 5 loans availed in 2010 was passed on to DD Global by way of adjustment of outstanding dues of the year 2008. The outstanding dues arising out of original loan availed in 2008 were converted into 5 new loans in 2010 and since the aforesaid 5 loan agreements contain an arbitration clause, the present arbitration proceeding was rightly initiated and is maintainable in law.

Further, Delhi HC observed that the learned Single Judge of Delhi HC has arrived at a finding that the conclusion made by the learned Arbitrator, both in terms of facts and law, is a plausible conclusion and there is no reason to disturb the conclusion recorded by the learned Arbitrator. It is a settled law that if the interpretation and conclusion arrived at by the learned Arbitrator is a plausible one, judiciary ought to refrain from disturbing such findings. In this regard, Delhi HC relied upon the judicial pronouncement rendered by the Supreme Court in the matter of ***MMTC Limited v. Vedanta Limited [(2019) 4 SCC 163]***, whereby it was held that the court hearing an appeal under Section 37 of the Arbitration Act must be very cautious in disturbing concurrent findings given by the learned Arbitrator and confirmed by the appropriate court in view of challenge under Section 34 of the Arbitration Act.

Further, Delhi HC observed that the contention raised by the Appellants and reliance placed by them on various judgments is highly misplaced in so far as the submission that Respondent had unilaterally appointed the learned Arbitrator. In this regard, Delhi HC observed that the present arbitration proceeding was invoked by letter dated September 25, 2012 whereas the amendment in Arbitration Act was introduced in 2015, whereby a party interested in the outcome of arbitration proceeding has no unilateral right to appoint an Arbitrator. Therefore, the Appellants cannot raise such contention.

Decision of the Delhi HC

Delhi HC held that transfer of liabilities from a previous loan agreement makes the arbitration clauses in subsequent agreements binding. In view of the aforesaid ratio laid down, the Division Bench of Delhi HC was pleased to dismiss the appeal.

VA View: The present judicial pronouncement rendered by the Division Bench of Delhi HC provides clarity on multiple issues.

The present judgment had laid down the ratio that if liabilities stand transferred from the original agreement to a subsequent agreement, in that case an arbitration clause stipulated in the subsequent agreement will be binding to invoke arbitration proceeding in respect of the original agreement even if the original agreement had no stipulation of arbitration clause.

Further, this judgment clarifies the position on unilateral appointment of learned Arbitrator in view of amendment to the Arbitration Act in the factual context of those cases wherein the arbitration proceeding was invoked prior to the aforesaid amendment in the year 2015.

Lastly, this judgment reiterates the well settled legal position that when the findings arrived at by the learned Arbitrator and if such findings have been confirmed by an appropriate court pursuant to challenge to arbitral award in terms of Section 34 of the Arbitration Act, then the higher judiciary ought to be cautious in disturbing such findings recorded by the learned Arbitrator.

III. NCLAT: No bar on the initiation of CIRP, if default is committed prior to Section 10A Period and continues during the Section 10A Period.

National Company Law Appellate Tribunal, New Delhi ("**NCLAT**") in the case of ***Beetel Teletech Limited v. Arcelia IT Services Private Limited [Company Appeal (AT)(Insolvency) No. 1459 of 2022]***, *vide* its order dated September 11, 2023, held that there is no bar on the initiation of Corporate Insolvency Resolution Process ("**CIRP**") if a default is committed prior to period when Covid-19 pandemic was prevailing and continues during the period when Covid-19 pandemic was prevailing ("**Section 10A Period**"), since initiation of CIRP during Section 10A Period was suspended by introduction of Section 10A (*Suspension of initiation of corporate insolvency resolution process*) of the Insolvency and Bankruptcy Code, 2016 ("**IBC**") and not prior to Section 10A Period.

Facts

A channel partner registration form was executed between M/s. Beetel Teletech Limited ("**Operational Creditor/ Appellant**") and M/s. Arcelia IT Services Private Limited ("**Corporate Debtor/ Respondent**"), wherein both parties had agreed to work on mutually accepted terms and conditions. A purchase order dated October 25, 2019, was raised by the Corporate Debtor pursuant to which an invoice no. RV1927813879 dated December 31, 2019 of an amount of INR 1,32,45,904.84 ("**Service Invoice**"), was raised by the Operational Creditor for suppling goods and services. However, the payment by Corporate Debtor towards Service Invoice remained unpaid.

To recover the dues, ample reminders were made by the Operational Creditor and several meetings were held between the Corporate Debtor and the Operational Creditor. Further, the Operational Creditor issued a demand notice under Section 8 (*Insolvency resolution by operational creditor*) of IBC for

recovering the dues. However, no reply to the demand notice was filed by the Corporate Debtor. As a result of which, an application for initiation of CIRP was filed under Section 9 (*Application for initiation of corporate insolvency resolution process by operational creditor*) of IBC on December 15, 2021 by the Operational Creditor against the Corporate Debtor ("**Application**") and a reply to the Application was filed by the Corporate Debtor.

However, the Application was dismissed by National Company Law Tribunal, New Delhi ("**NCLT**") as not maintainable, on the grounds that the interest claimed by the Operational Creditor falls during the period March 25, 2020 to March 24, 2021, for which no CIRP could have been initiated as per Section 10A of IBC and has also failed to establish beyond doubt that the unpaid operational debt was above the minimum threshold limit of INR 1 crore. Additionally, NCLT opined that part payments made by the Corporate Debtor was adjusted by the Operational Creditor towards other debts and not against the unpaid invoice which is claimed in the Application and there was no consistency in the treatment accorded to the part payments. Aggrieved by the said order, an appeal was filed before the NCLAT against the order of NCLT by the Operational Creditor.

Issues

1. Whether the interest accrued during Section 10A Period can be included while computing the INR 1 crore threshold limit.

2. Whether the part-payment received from the Corporate Debtor can be adjusted by the Operational Creditor towards other debts.

Arguments

Contentions of the Appellant:

It was contended by the Appellant that in terms of payment conditions followed by the two parties, the payments were to be made by the Corporate Debtor within 60 days from the date of invoice and the Corporate Debtor was liable to pay interest at the rate of 18% per annum if payment was not cleared within a time period of 60 days. The Service Invoice fell due for payment on February 29, 2020, for which certain payments were received from the Corporate Debtor, which were adjusted against the Service Invoice and other outstanding invoices. Despite these adjustments, certain payments remained outstanding towards the Service Invoice. Although the Appellant took up the matter with the Corporate Debtor for release of the outstanding debt, only part payments were made against the said invoice by the Corporate Debtor.

The Appellant also submitted that a demand notice was issued pursuant to Section 8 of IBC by the Appellant as a cheque issued by the Corporate Debtor got dishonoured for which the Corporate Debtor did not file any reply. After the demand notice was issued, two cheques amounting to INR 5 lakhs were issued by the Corporate Debtor which were adjusted by the Appellant against other pending invoices. However, the operational debt pertaining to the Service Invoice subsisted, resultantly an application under Section 9 of IBC was filed. As per the Appellant, the operational debt claimed is confined to the Service Invoice for an amount of INR 1,15,11,486 inclusive of principal amount of INR 1,01,80,986 along with an interest amount of INR 13,30,500 at the rate of 18% per annum. Therefore, the Appellant submitted that the default in payment arose before March 25, 2020 and the interest accruing on the

principal amount should also be treated as a part of the operational debt and taken into consideration while computing the minimum threshold limit.

The Appellant contended that NCLT erroneously dismissed the application by the Appellant under Section 9 of IBC on the ground that the threshold limit of INR 1 crore is not fulfilled.

Contentions of the Respondent:

Despite the notice being served by NCLAT, there was no appearance made by anyone on behalf of the Corporate Debtor before the NCLAT since the first date of hearing which was on December 13, 2022.

Observations of NCLAT

NCLAT relied upon the judgement of the Supreme Court in the case of ***Ramesh Kymal v. Siemens Gamesa [Civil Appeal No. 4050 of 2020]*** wherein the Apex Court observed the object and intent underlying the insertion of Section 10A of IBC. It was held by NCLAT that Section 10A of IBC signifies that no application/ proceedings under Sections 7, 9 and 10 can be initiated for any default in payment which is committed during Section 10A Period. However, the said bar for initiation of CIRP is not applicable in respect of those defaults which are committed prior to the Section 10A Period and continues in the Section 10A Period. It was observed by NCLAT that the aim and objective of Section 10A of IBC was to protect a corporate debtor from any insolvency application against it for any default committed during the period when Covid-19 pandemic was prevailing. It was never intended to cover any default which occurred before Section 10A Period and continuing thereafter.

NCLAT noted that in the present case, the default has been committed by the Corporate Debtor since February 29, 2020, which is prior to commencement of Section 10A Period. Hence, the default was committed before the bar of Section 10A of IBC came into play and the Corporate Debtor is not entitled to claim the benefit of Section 10A Period. Furthermore, NCLAT held that since the default was committed prior to Section 10A Period and the liability for payment of interest having clocked prior to Section 10A Period, the opinion of NCLT that the liability of interest which accrued during Section 10A Period should be ignored or should not be computed for triggering CIRP, is misconceived.

In respect of the issue that whether the Operational Creditor can adjust part-payments which it has received from the Corporate Debtor towards other debts, NCLAT relied upon Section 60 (*Application of payment where debt to be discharged is not indicated*) of the Indian Contract Act 1872, and observed that if a debtor makes any payment without any appropriation, then the creditor can use his discretion to wipe out any of the remaining debt(s) which is/are due. Hence, if the debtor has not indicated the manner in which the debt is to be discharged, the creditor has the right of appropriation and therefore, the creditor has the scope to exercise his right in such a manner which puts him in the most advantageous position. Additionally, NCLAT held that it is a well settled business practice that in a debt where the principal amount is outstanding and interest has also accrued on the debt, sums paid by the debtor is applied by the creditor first to the interest.

NCLAT observed that payments received by the Operational Creditor have been duly adjusted against invoices in addition to the Service Invoice which were all pending for payment. Additionally, NCLAT observed that NCLT was unreasonable to hold that there is inconsistency in the pattern adopted by the Operational Creditor while adjusting payments received against outstanding dues as NCLT passed the

order without any explanation as to how the action of adjusting the payments received by the Operational Creditor has contravened any provision contained in the Indian Contract Act, 1872.

Decision of NCLAT

NCLAT held that the order of NCLT is not tenable. Therefore, NCLAT allowed the appeal of the Operational Creditor and set aside the order of NCLT.

Further, NCLAT revived the application for CIRP filed by the Operational Creditor under Section 9 of IBC and remanded it back to NCLT for its consideration as per the law.

VA View: The observation of NCLAT has brought into light the significance of the aims and objective of Section 10A of IBC which was to grant protection to a corporate debtor from any insolvency application against it for any default committed during the period when Covid-19 pandemic was prevailing and not to cover any default which occurred before Section 10A Period and continuing thereafter.

NCLAT has also emphasized on the fact that there must be no conflict between the provisions of the Indian Contract Act, 1872 and the spirit of IBC; and gave remarkable significance to both the provisions of the Indian Contract Act, 1872 as well as IBC and thus observed that neither of the statutes should not encroach upon the sphere of the other legislation.

IV. Gujarat HC: Purchaser of an asset in a liquidation process is not liable for payment of government dues which were not substantiated adequately during the CIRP and not lodged with the liquidator.

The Gujarat High Court ("**Gujarat HC**") has, by its judgment pronounced on September 22, 2023, in the matter of ***KRBL Limited v. State of Gujarat [C/SCA/19804/2022]***, held that the purchaser of an asset in a liquidation process of a corporate debtor is not responsible for payment of any government dues, if the claim was not adequately substantiated during the Corporate Insolvency Resolution Process ("**CIRP**") and on failure to lodge the claim with the liquidator.

Facts

The Mumbai bench of National Company Law Tribunal ("**NCLT**"), *vide* its order dated January 17, 2020, admitted insolvency proceedings initiated against M/s. Gran Electronics Private Limited ("**Corporate Debtor**") by Universal Digital Connect Limited. The claim of Sales Tax Department ("**Respondent**") of an amount of INR 77,08,69,644 was rejected by the resolution professional on inadequacy of proof.

Thereafter, an application to liquidate the Corporate Debtor was admitted by NCLT on February 12, 2021. The Respondent failed to register its claim with the liquidator, despite a letter dated February 23, 2021 being issued by the liquidator to Assistant Commissioner of Tax. The liquidator initiated the sale of assets of Corporate Debtor by means of an e-auction. KRBL Limited ("**Petitioner**") purchased a piece of land, which was a part of the liquidation corpus of the Corporate Debtor. The purchase was recorded *vide* sale deed dated December 17, 2021 containing an express stipulation thereunder that the

Petitioner will not be responsible to pay any due amount to the government, since it will be dealt with in the manner specified in Section 53(1) of Insolvency and Bankruptcy Code, 2016 ("**IBC**").

The Gram Panchayat of Varsamedi intimated the Corporate Debtor to pay outstanding property tax. The liquidator informed the Panchayat that any dues other than secured, unsecured or of the workman and employees, including the dues of Respondent, will fall under operational creditors. *Vide* notice dated January 10, 2022, the Respondent intimated attachment of the land in question. A pencil entry bearing no. 4454 was mutated in favor of the Petitioner. On a request made by the Petitioner on February 16, 2022, to certify the entry, the Talati-cum-Mantri refused to do so on the ground of existence of a charge of the Respondent. By the impugned order dated January 5, 2022, the Respondent demanded an amount of INR 56,01,79,095 towards outstanding GST dues and mutated entry no. 6295, *inter alia*, recording a charge on the property of the Respondent. Hence, the Petitioner approached the Gujarat HC with a writ petition under Article 226 of the Constitution of India to certify the entry no. 4454 in revenue record and to set aside order dated January 5, 2022 and further to set aside the consequential entry no. 6295 mutated in the revenue record petition.

Issue

Whether the purchaser of an asset in an auction is liable to pay the government dues which are not lodged with the liquidator at the time of liquidation process.

Arguments

Contentions of the Petitioner:

The Petitioner submitted that IBC is a complete code which deals with solutions on a holistic perspective concerning a company and all stakeholders, including the company, creditors, purchasers start with a '***clean slate***'. The Petitioner to strengthen its arguments, placed reliance on ***Ghanshayam Mishra and Sons Private Limited v. Edelweiss Asset Reconstruction Company Limited [(2021)/ 9/ SCC/ 657]***, wherein the Supreme Court held that a successful resolution applicant cannot suddenly be faced with an undecided claim after a resolution plan submitted by him has been approved.

The Petitioner also emphasized, while relying on the ***Paschimanchal Vidhyut Vitran Nigam Limited v. Raman Ispat Private Limited and others [Civil Appeal No. 7976 of 212]*** ("**Paschimanchal Case**"), that Sections 52 *(Secured Creditor in liquidation proceedings)* and 53 *(Distribution of assets)* are complete and comprehensive and all rights even of secured creditors in the secured assets stands diluted and compromised. Once a property is sold by the liquidator in the public auction and on "as is where is basis," a secured creditor cannot be allowed to assert an entry for the asset once sold.

The Petitioner further submitted that even as per Section 100 *(Charges)* of Transfer of Property Act, 1882 ("**TPA**"), a charge created by operation of law or otherwise is not mortgage, and a charge cannot be enforced against any property in the hands of the person to whom such property has been transferred for consideration and without any notice of charge. The Petitioner had no notice of pending government dues, and as such is not liable to pay the government dues.

Contentions of the Respondent:

The Respondent submitted that Section 31 (*Approval of Resolution Plan*) of IBC is not applicable to the facts of the present case. Since the insolvency proceedings did not materialize, the rights of the Respondent did not extinguish. The rights of the Respondent are restored, since there was a failure of insolvency resolution process.

The Respondent further submitted that since the asset was sold on "as is where is basis", the rights of the Respondent stood secured. They do not stand relinquished even if the distribution is done after following Section 53 (*Distribution of assets*) of IBC. The Respondent emphasized that since the asset

was sold on an "as is where is basis", ratio laid down in Paschimanchal Case, should not be applied to present case.

Observations of the Gujarat HC

Gujarat HC analyzed the facts of the case that CIRP was undertaken and claims were invited and the Respondent failed to substantiate it and at the stage of liquidation did not lodge its claim. Gujarat HC placing reliance on judgments pronounced by Supreme Court observed that the debt of the Respondent did not form part of the resolution plan and therefore stood extinguished.

Gujarat HC examined Sections 52 and 53 of IBC and asserted that the Respondent as an operational creditor would have to fall in line as per the "waterfall mechanism".

Gujarat HC relied upon judgments pronounced in the matter of ***Ghanshayam Mishra and Sons Private Limited v. Edelweiss Asset Reconstruction Company Limited [(2021)/9/SCC/657]*** and Paschimanchal Case and reiterated that once having relinquished its interest under Section 52, the Respondent cannot continue the insistence of maintaining the charge in the revenue records and its claim will have to stand in priority.

Thereafter, Gujarat HC discussed that the dissenting argument of the Respondent, that since the asset was sold on "as is where is basis" and the charge of the Respondent was rightly recorded, is misconceived as the sale deed already records that the purchaser shall not be liable for payment of any outstanding dues of the government.

Gujarat HC also deduced Section 100 of TPA in a manner that a charge cannot be enforced against any person who has bought the property for consideration and has no notice of such charge.

Decision of the Gujarat HC

Gujarat HC held that the Petitioner was entitled to a '***clean slate***'. The Court set aside the order dated January 5, 2022, passed by the Respondent and mutated entry no. 6295 in the revenue records. It further directed the Talati-cum-Mantri to certify entry No. 4454 in the revenue records pursuant to the sale of land in question by registered sale deed dated December 17, 2021.

VA View: The present judgment of Gujarat HC is a significant judicial pronouncement in the realm of insolvency law.

Gujarat HC has protected the rights of the purchaser of an asset in the liquidation process against claims that are not substantially proved during the CIRP and are not lodged with the liquidator at the time of liquidation process. This decision strengthens the enforcement mechanism of IBC. Gujarat HC has clarified the position of law that the purchaser of an asset under IBC is not liable to pay any dues to any government authority, since all dues, claims and debts will be dealt as per the "***waterfall mechanism***". The government authorities cannot insist on the payment of dues, if the claim has not been lodged with the liquidator within the stipulated time. Gujarat HC also clarified the law under TPA that charge cannot be enforced against any person who has bought the property for consideration and has no notice of such charge.

Contributors:

Navya Shukla, Pritika Shetty, Rishabh Chandra, Saksham Kumar and Sanchi Agarwal

Disclaimer:

While every care has been taken in the preparation of this Newsletter to ensure its accuracy at the time of publication, Vaish Associates, Advocates assume no responsibility for any errors which may inadvertently appear. The Newsletter is circulated with the understanding that the author/ publisher is not rendering legal or professional advice or opinions on specific facts or matters and, accordingly, assume no liability whatsoever in connection with its use.

NEW DELHI
1st, 9th and 11th Floor,
Mohan Dev Bldg,
13 Tolstoy Marg,
New Delhi - 110001, India
Phone: +91-11-42492525
Fax: +91-11-23320484
delhi@vaishlaw.com

MUMBAI
106, Peninsula Centre,
Dr. S.S. Rao Road, Parel,
Mumbai - 400012, India
Phone: +91-22-42134101
Fax: +91-22-2134102
mumbai@vaishlaw.com

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