

Insolvency and Bankruptcy Hotline

August 23, 2017

BANKRUPTCY CODE: LIMITATION ACT NOT APPLICABLE!

- Limitation Act, 1963 does not apply to proceedings under Insolvency & Bankruptcy Code, 2016
- Debenture Holders would qualify as financial creditor irrespective of the applicable interest rate

The National Company Law Appellate Tribunal (“**NCLAT**”) has recently ruled that the Limitation Act, 1963 is not applicable to the Insolvency & Bankruptcy Code, 2016 (“**IBC**”). In effect, the NCLAT has held that debts which were otherwise not recoverable due to being time barred, can now be basis for initiating insolvency proceedings. This is a stark change from the earlier position and paves way for initiation of multiple insolvency proceedings on debts which could earlier not be recovered.

The case also dealt with other interesting issues which are generally applicable to structures involving issuance of convertible and non-convertible debentures.

FACTS:

The judgment in *Neelkanth Township & Construction Pvt. Ltd. v. Urban Infrastructure Trustees Ltd.*¹ was pursuant an appeal filed by a corporate debtor (Neelkanth Township & Construction Pvt. Ltd.) against the order of the National Company Law Tribunal (“**NCLT**”) allowing commencement of insolvency proceedings on the action of the financial creditor (Urban Infrastructure Trustees Ltd.).

The financial creditor had subscribed to optionally convertible debentures (“**OCDs**”) issued by the corporate debtor. OCDs carried nil or 1% p.a. interest rate and matured in years 2011, 2012 and 2013.

The order of the NCLT was challenged by the corporate debtor, amongst others, on following grounds:

1. Given that the debentures matured in years 2011, 2012 and 2013, the petition for initiation of corporate insolvency resolution process filed in year 2017 is time barred.
2. The application of the financial creditor before NCLT was not complete as it did not contain document prescribed under Section 7(3)(a) of the IBC;
3. The financial creditor is actually an investor and not a ‘Financial Creditor’ as defined under the IBC.

JUDGMENT:

Time – Barred Debt:

The NCLAT held that that in the absence of any provision in IBC, the Limitation Act, 1963 would not be applicable to initiation of Corporate Insolvency Resolution Process. The NCLAT further observed:

“If there is a debt which includes interest and there is default of debt and having continuous course of action, the argument that the claim of money by Respondent is barred by Limitation cannot be accepted.”

This suggests that NCLAT treated the cause of action arising from non-payment of debt which includes interest as a continuing one. Thereby holding that limitation period could not have expired.

Compliance with Section 7(3)(a) of the IBC:

Section 7(3)(a) provides:

“(3) The financial creditor shall, along with the application furnish—(a) record of the default recorded with the information utility or such other record or evidence of default as may be specified;”

The Insolvency & Bankruptcy Board of India (“**Board**”) has not specified any other record or evidence of default which may be furnished. Further, as there was no record of default recorded with the information utility, it was contended that the application filed was incomplete. However, the NCLAT rejected the argument, holding that a procedural requirement could not frustrate the substantive provision of law. Failure of the Board to frame regulations could not be lead to inability of the adjudicating authority from dealing with application for initiation of insolvency resolution process.

The NCLAT also referred to the Rule 41 of the Insolvency & Bankruptcy (Application to Adjudicating Authority) Rules, 2016 whereby a financial creditor is required to make an application in accordance with prescribed form – 1. Part V of the said form prescribes the particulars that need to be provided as part of the application. The NCLAT ruled that in absence any regulation framed by the Board, the evidence of default, records and documents prescribed under Part V of the Form – 1 will be sufficient to determine default of debt under Section 7 of the IBC. Regulation 8 of Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 was also relied upon to substantiate the documents and records the financial creditor could rely upon to prove a claim.

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As a financial creditor is one to whom a financial debt is owed, issue arose regarding meaning of financial debt. Financial debt is defined under Section 5(8) of IBC as:

“(8) “financial debt” means a debt alongwith interest, if any, which is disbursed against the consideration for the time value of money and includes—

...

(c) any amount raised pursuant to any note purchase facility or the issue of bonds, notes, debentures, loan stock or any similar instrument;” (Emphasis supplied)

It was argued by the corporate debtor that considering that the interest rate on the OCDs was 0 or 1%, they were not issued against consideration for the time value of money. In fact, the subscriber to the OCDs was an investor in the company and not a financial creditor. However, the NCLAT held that section 5(8)(c) makes it clear that a debenture comes within the meaning of financial debt. Thus, in the present case, the amounts owed on maturity of debentures would be a financial debt.

COMMENT:

The ruling of NCLAT holding that debenture comes within the meaning of financial debt, irrespective of the applicable interest rate is useful for the industry. OCDs with nil or negligible interest rates were on various occasions used in structures such that the holder of the instrument would benefit from being in a position of a creditor till such time that the OCDs were converted into equity. This judgment now confirms that such structures would not imply that the subscriber to the OCDs would get the color of an equity shareholder prior to its conversion. Further, the ruling in context of fulfillment of requirement of Section 7(3)(a) of IBC is also welcome. It reflects the NCLATs approach of ensuring due working of the IBC.

Under the Companies Act, 1956, a winding up petition was considered maintainable only against a debt which was legally recoverable.² Accordingly, a winding up could not be ordered where the recovery of the debt was barred by limitation.³ However, the current stand of NCLAT seems to completely change the position. This ruling effectively allows parties to initiate insolvency proceedings on basis of old debts which could not be recovered due to expiry of limitation period. This could open the flood gates for petitions under the IBC. Further, the NCLAT has not referred to Section 433 of the Companies Act, 2013 in its judgment. Section 433 provides that the Limitation Act, 1963 is applicable to proceedings before NCLT and NCLAT. Thus, parties should be cautious before relying on this judgment of NCLAT. Ideally parties should continue initiating insolvency proceedings within the limitation period for the recovery of the original debt.

— Ashish Kabra & Vyapak Desai

You can direct your queries or comments to the authors

¹ Company Appeal (AT) (Insolvency) No. 44 of 2017

² In re Marine Container Services (India) (P) Ltd., (1999) 2 Mah LJ 728

³ *Vijayalakshmi Art Productions v. Vijaya Productions (P) Ltd.* (1997) 88 Com Cases 353; *Modern Dekor Painting Contracts Private Ltd. v. Jenson and Nicholson (India) Ltd.*, (1985) 58 Comp Cas 257; *The Jayabharat Credit Limited v. Jalgaon Re-Rolling Industries Ltd.*, (1997) 99 (1) Bom LR 521; *Rameswar Prasad Kejriwal & Sons Ltd. v. M/s. Garodia Hardware Stores*, (2002) 108 Comp Cas 187

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