



ERGO

Analysing developments impacting business

BALANCE SHEET AND ACKNOWLEDGMENT OF LIABILITY IN IBC – DEBATE FAR FROM SETTLED

13 October 2020

A contentious issue in the interplay between the Insolvency and Bankruptcy Code, 2016 (IBC) and the Limitation Act, 1963 (Limitation Act) has been the applicability of Section 18 of the Limitation Act (Section 18), which stipulates that a fresh period of limitation shall be computed from the time of the acknowledgement of liability in writing before the expiration of the prescribed period of limitation. In the context of IBC, the question is whether such an acknowledgement of debt in entries in a balance sheet would extend the limitation period for the purposes of filing an application for the initiation of corporate insolvency resolution process (CIRP) under Section 7 of the IBC (Section 7 Application).

On this point, the National Company Law Appellate Tribunal (NCLAT) in *V. Padmakumar v. Stressed Assets Stabilisation Fund & Anr* 2020 SCC OnLine NCLAT 417 (*Padmakumar*) held that entries in a balance sheet do not constitute an acknowledgement of debt under Section 18. As explained in our *previous post*, *Padmakumar* deviated from the well settled position of law on this issue.

While *Padmakumar* was not appealed before the Hon'ble Supreme Court of India (Supreme Court), *Padmakumar* was re-examined once again by the NCLAT in *Bishal Jaiswal v. Asset Reconstruction Company (India) Limited and Anr* (25 September 2020, Company Appeal (AT) (Insolvency) No. 385 of 2020) (*Bishal*). In this case, the NCLAT referred the judgment in *Padmakumar* for reconsideration to a larger bench (Reference). In this Ergo, we shall discuss the grounds on which the NCLAT made the Reference.

FACTS OF THE CASE

In 2014, Corporate Power Limited (Corporate Debtor) had availed credit facilities from a consortium of lenders (Lenders) but defaulted on its payment obligations. Thereafter, the Lenders issued loan recall notices in 2015 and subsequently assigned their credit facilities in favour of Asset Reconstruction Company (India) Limited (ARCIL). Thereafter, ARCIL filed a Section 7 Application in 2018 before the Kolkata bench of the Hon'ble National Company Law Tribunal (NCLT-Kolkata) for initiation of CIRP against the Corporate Debtor. At the stage of admission of the Section 7 Application before the NCLT-Kolkata, the Corporate Debtor contested the admissibility of the Section 7 Application mainly on the grounds that the said application was barred by limitation. The NCLT-Kolkata held that the Corporate Debtor acknowledged the debt in its balance sheet in 2017 thereby renewing the computation of the limitation period and hence, the Section 7 Application filed in 2018 was therefore within limitation period (judgment

dated 19 February 2020 in CP (IB) no. 23/KB/2019). An appeal was filed from NCLT Kolkata's judgment before NCLAT.

Submissions of the Corporate Debtor: The Corporate Debtor argued that though its accounts were declared as a non-performing asset (NPA) by Lenders in 2014, the Section 7 Application was filed by ARCIL in 2018, after a delay of almost five years, and thus was time-barred. Further, the records of debt in its balance sheet could not be considered an acknowledgement of debt in writing under Section 18 in light of the observations of NCLAT in *Padmakumar*, since they had been made involuntarily and under compulsion of law. It was also submitted that the Supreme Court in *Babulal Vardharji Gurjar v. Veer Gurjar Aluminum Industries Private Limited* (2020) SCC OnLine SC 647 had held that Section 18 is not applicable to insolvency cases (*Babulal*). Accordingly, the decision made by the 5 (five) member bench of the NCLAT in *Padmakumar* does not need reconsideration and is binding on the 3 (three) member bench in *Bishal*.

Arguments of ARCIL: ARCIL argued that it is a settled position of law that entries in a balance sheet amount to an acknowledgement of debt for the purposes of Section 18. After the Corporate Debtor's account was classified as NPA by Lenders, the Corporate Debtor repeatedly admitted and acknowledged its debt in its balance sheet for the financial years ending 31 March 2015, 31 March 2016 and 31 March 2017, due to which the limitation period started afresh with each acknowledgement of the debt. It was further submitted that the Supreme Court in *Babulal* merely declined to provide the concerned creditor the benefit of Section 18 in light of the unique facts and circumstances of the case and did not lay down a general principle that provisions of Section 18 are not applicable to IBC.

OBSERVATIONS OF NCLAT

The NCLAT observed that *Padmakumar* merits reconsideration *inter-alia* on the following grounds:

- It is well-established that entries in a balance sheet are acknowledgements of debt under Section 18. Accordingly, the majority opinion in *Padmakumar* took a view which was contrary to a well-settled position of law without according reasons.
- The reasoning used in *Padmakumar* to find that mandatory filing of balance sheet under Section 92 of the Companies Act, 2013 ("CA 2013") did not amount to an acknowledgement of liability had earlier been rejected in *Bengal Silk Mills Co. v. Ismail Golam Hossain Ariff*, AIR 1962 Cal. 115. It was observed that balance sheet contains an admission of liability, and agents of the company who make and sign the balance sheet intend to make those admissions. Thus, balance sheets do not cease to be an acknowledgement of liability merely because such acknowledgments arise from a statutory obligation.
- As regards *Babulal*, the NCLAT noted the observations of the Supreme Court that the question of limitation is essentially a mixed question of law and fact and when a party seeks application of any particular provision for extension or enlargement of the period of limitation, the relevant facts are required to be pleaded and requisite evidence is required to be adduced. The Supreme Court observed in *Babulal* that the creditor did not plead any acknowledgment of debt by the borrower and accordingly, declined to provide the benefit of Section 18 to the concerned creditor. The NCLAT observed that the aforesaid observations of the Supreme Court cannot be construed to have laid down a general principle that Section 18 is inapplicable to IBC.

In addition to the above, the NCLAT also laid down the guiding principle to be followed by a smaller bench of a court/tribunal (Smaller Bench) for referring a judgment to a larger bench of such court/tribunal (Larger Bench) for reconsideration. Ordinarily, the judgment of a Larger Bench is binding on the Smaller Bench. However, if the Smaller Bench concludes that the judgment rendered by the Larger Bench is so very *incorrect that in no circumstances can it be followed*, it would have to refer the matter to a Larger Bench setting out its reasons for disagreement with the view of the Larger Bench. Thus, the NCLAT set a relatively high threshold for a Smaller Bench to seek a Reference and deviate from the decision of a Larger Bench.

COMMENT

Considering that the majority opinion in *Padmakumar* deviated from a well-established legal position, the NCLAT in *Bishal* took cognizance of this deviation and observed that the dissenting opinion of Justice Cheema in *Padmakumar* is in line with settled jurisprudence on this subject. It remains to be seen if the bench constituted pursuant to the Reference follows *Padmakumar*. This can have far reaching effects on legacy cases of default which were outstanding/in default for more than three years before IBC was enacted.

- *Kumar Saurabh Singh (Partner), Rahul Chakraborti (Principal Associate) and Ashwij Ramaiah (Associate).*

For any queries please contact: editors@khaitanco.com

We have updated our [Privacy Policy](#), which provides details of how we process your personal data and apply security measures. We will continue to communicate with you based on the information available with us. You may choose to unsubscribe from our communications at any time by clicking [here](#).

For private circulation only

The contents of this email are for informational purposes only and for the reader's personal non-commercial use. The views expressed are not the professional views of Khaitan & Co and do not constitute legal advice. The contents are intended, but not guaranteed, to be correct, complete, or up to date. Khaitan & Co disclaims all liability to any person for any loss or damage caused by errors or omissions, whether arising from negligence, accident or any other cause.

© 2020 Khaitan & Co. All rights reserved.

Mumbai

One Indiabulls Centre, 13th Floor
Tower 1 841, Senapati Bapat Marg
Mumbai 400 013, India

T: +91 22 6636 5000
E: mumbai@khaitanco.com

New Delhi

Ashoka Estate, 12th Floor
24 Barakhamba Road
New Delhi 110 001, India

T: +91 11 4151 5454
E: delhi@khaitanco.com

Bengaluru

Simal, 2nd Floor
7/1, Ulsoor Road
Bengaluru 560 042, India

T: +91 80 4339 7000
E: bengaluru@khaitanco.com

Kolkata

Emerald House
1 B Old Post Office Street
Kolkata 700 001, India

T: +91 33 2248 7000
E: kolkata@khaitanco.com