



## ERGO

*Analysing developments impacting business*

### BALANCE SHEET AND ACKNOWLEDGEMENT OF DEBT IN IBC – HANGING IN BALANCE NO MORE!

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A three-judge Bench of the Supreme Court (SC), by a common judgement in *Asset Reconstruction Company (India) Limited vs. Bishal Jaiswal* (15 April 2020, Civil Appeal No 323 of 2021) and related matters, has held that the for the purposes of Insolvency and Bankruptcy Code, 2016 (IBC), balance sheet entries could constitute an acknowledgment of debt under Section 18 of the Limitation Act, 1963 (Limitation Act).

In doing so, the three-judge bench has set aside the majority decision of the National Company Law Appellate Tribunal (NCLAT) in *V. Padmakumar v Stressed Assets Stabilisation Fund (Respondent) & Anr* (2020 SCC OnLine NCLAT 417) (*Padmakumar*), which had deviated from the well settled position of law on the issue as explained in our previous [post](#).

#### BACKGROUND

A three member bench of NCLAT by its order dated 25 September 2020 in *Bishal Jaiswal v. Asset Reconstruction Company (India) Limited* (2020 SCC OnLine NCLAT 681) (*Bishal Jaiswal*) had doubted the correctness of the judgment in *V Padmakumar*, and had referred the matter for reconsideration to a larger bench, for the reasons explained by us in our previous [post](#). Subsequently, a five member bench of the NCLAT refrained from deciding the issue on merits, asserting that the reference itself was incompetent. Consequently, ARCIL appealed before the SC. The appeal by ARCIL along with four other appeals challenging the majority decision in *V Padmakumar* were decided together by the SC. The details of the Supreme Court judgment are set out hereinbelow.

#### SUBMISSIONS BEFORE THE SC

*Submissions of ARCIL:* ARCIL contended that *V Padmakumar* is *per incuriam* on the grounds that it did not consider a catena of judgments of the Supreme Court and High Courts whereby it has been expressly held that the balance sheet entries of a company which are duly signed would amount to an acknowledgement of liability. ARCIL further argued that even though a balance sheet has to be filed under a statutory compulsion, that itself does not mean that an acknowledgement of liability also has to be made under the statutory compulsion.

*Submissions of the Respondent:* The Respondent argued that balance sheets are relevant in recovery proceedings only and cannot be relied upon in proceedings under the IBC. It was additionally argued that in the present matter, the balance sheets did not amount to an acknowledgement of liability as the auditor's report, read with the balance sheets, caveats the acknowledgement of debt.

**FINDINGS AND OBSERVATIONS (JUDGMENT)**

- Section 18 of Limitation Act is applicable to the IBC by virtue of Section 238A of the IBC

Relying on the recent judgments of the Supreme Court in *Sesh Nath Singh* (2021 SCC OnLine SC 244) and *Laxmi Pat Surana* (2021 SCC OnLine SC 267), the SC observed that the rationale for introducing Section 238A of the IBC is to make the Limitation Act applicable to proceedings under the IBC “as far as may be”. It was stated that there is no reason why Section 18 of the Limitation Act would be excluded from being applicable to the IBC, provided that the acknowledgement of debt is made before expiry of limitation.

- Balance Sheet entries can amount to acknowledgment of debt under Section 18 of the Limitation Act

Citing decisions of several High Courts and the Supreme Court, the SC noted and held as follows:

Intention of acknowledging the debt is irrelevant

The SC while relying upon *Khan Bahadur Shapoor Fredoom Mazda v. Durga Prasad*, ((1962) 1 SCR 140) held that there is no requirement of intention of acknowledging the debt for the purposes of Section 18 of the Limitation Act as long as the acknowledgement establishes jural relationship between the debtor and the creditor.

While the filing of a balance sheet is under compulsion of law, the acknowledgement of debt thereunder is not

The SC while recognising that filing of balance sheet is mandatory under law, held that there is no compulsion to make any particular admission of debt in the balance sheet as the notes or the auditor’s report may enter necessary caveats in relation to any acknowledgement. The Court pointed out that the notes annexed to the financial statements are expressly recognised by Section 134 (7) of the Companies Act 2013 and these notes can qualify any entry in relation to a liability in the balance sheet. Therefore, in each case, the balance sheet has to be harmoniously read with such notes/ clarifications, to determine if the entry regarding a creditor in the balance sheet, is made unequivocally or with caveats. This would, then aid in establishing whether the entry in the balance sheet would amount to an acknowledgement of liability.

Balance sheet must be approved by shareholders and accompanied by Directors’ report

The SC relied upon the judgment of the Calcutta High Court in *Pandam Tea Co. Ltd, In re*, (1973 SCC OnLine Cal 93) wherein the court held that a balance sheet must be duly passed by the shareholders and accompanied by a report of the Directors for it to be validated.

**ORDER**

The SC set aside the majority decision in *Padmakumar*, along with the NCLAT’s order dismissing the reference in *Bishal Jaiswal* and remanded the appeals back to the NCLAT for a fresh determination on facts, with leave to the parties to amend their pleadings, where necessary.

**CONCLUSION**

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The decision of the SC has to be lauded as it clarifies some pertinent questions vis-à-vis the applicability of Limitation Act on IBC proceedings. The departure from an otherwise largely settled position in *V Padmakumar* had rendered the claims of several creditors time-barred. By upholding the dissenting opinion in *V Padmakumar*, the SC has clarified the significance of a balance sheet for the purposes of computing limitation period, and reiterated that the determination of whether an entry in a balance sheet amounts to an acknowledgement of liability must be made on a case-to-case basis, by reading the balance sheet holistically with the auditor's report and the notes thereto.

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