CS Makarand Joshi

CORPORATE LAWS

Case Law Update

Sanuj Bathla & Anr **..... (Petitioners) vs.** ***Manu Maheshwari & Anr*** **..... (Respondents). Delhi High Court of Delhi, judgment dated April 12th 2021**

Facts of the case

- Manu Maheshwari (Respondent) had given a loan of ₹ 52,00,000 @ 24% interest to M/s. Independent Disk Mastering, Private Limited (company) through account payee cheque in the name of the company on the request and persuasion by the directors of the company (petitioners) for smooth functioning of business.
- The company could not return it in time, as a result Shri Manu Maheshwari instituted a suit for recovery of ₹ 74,34,446/- against Company and its three Directors in trial court.
- Petitioners filed an application under Order I Rule 10 CPC in November 2014, inter alia, seeking deletion of their names from the array of parties on the ground that they were merely Directors in the Company and the Company had taken loan as a separate legal entity as also that there were no personal allegations of *mala-fide* or fraud against them and they were not personally liable.
- Subsequent to the filing of the said petition, respondent filed an application seeking amendment of the plaint to include allegations against petitioners for lifting of the corporate veil of the Company. However, this application was subsequently withdrawn by respondent.
- By the order dated 27.07.2018, Trial Court has dismissed the application filed by petitioners under Order I Rule 10 CPC, saying that "In view of the above facts and circumstances, it is directed that petitioner shall not be deleted as parties to the present suit at this stage.
- Further aggrieved by order of Trial Court petitioners filed a revision petition.
- The question of law for discussion here is whether the Trial Court was justified in dismissing the application seeking deletion of petitioner's name from array of parties by applying the doctrine of lifting the corporate veil.

Arguments on behalf of Respondents

- Petitioners were **directors and principal officers** of the Company and **in-charge and responsible for its day-to-day affairs** and thus jointly and severally liable and responsible for the acts done on behalf of the Company.
- It has been averred that petitioner had **jointly and personally requested** and **persuaded** the respondent for the **financial assistance/ help for smooth functioning** of the business of Company. Therefore, their presence is required for adjudication of the suit. So, they shall not be struck off as parties from the suit.
- Further quoted one judgement[1] of Delhi HC in which it has been held by the Hon'ble High Court of Delhi that there is no doubt about the fact that a company is a separate legal entity and has a distinct identity from Directors but this protection afforded to the Directors of the company is not ironclad or impenetrable. In reality, **individuals/persons are the ones, who run the company in the hope of reaping benefits out of it**. In a case where a court determines that a **company's business was not conducted in accordance with the provisions of corporate legislation, it can pull up the "corporate veil" and discover the true culprit.** This lifting of corporate veil' is essential for the purpose of determining the persons who are liable for any fraudulent or unlawful practices done in the garb of running a corporate body.
- It was argued that **Petitioners were Directors of the Company as on 16.01.2012, when the suit was filed against the Company.**
- Further argued that One of the **petitioners resigned** as Director on 28.12.2015 while other resigned on 20.11.2012. This was a **deliberate act to avoid the liability** of payment to the Plaintiff.
- **New directors** of the company stand **disqualified by ROC** under Section 164(2) of the Companies Act from 01.11.2017 to 31.10.2022. Information also reveals that the **Company has been 'struck off' from the MCA**. Summary of accumulated losses shows that the Company has been incurring losses from 2017, while the loss for the year 2013-2014 was ₹ 25,39,771/-. In these circumstances, **if petitioners are deleted from the array of parties and the decree is passed in favour of the Plaintiff, it will become in executable.**
- It was also argued by learned counsel for the Respondent that the application filed by the petitioners under Order I Rule 10 CPC for their deletion was misconceived and has been rightly dismissed by the Trial Court.

Arguments on behalf of petitioners

- Petitioners had filed one written statement before trial court wherein it

1. *M/s. Red Zebra Gift Promotion P. Ltd & Anr vs. Purnavi Events P. Ltd*'.

is pleaded that **Company is a corporate body** incorporated under Companies Act and has a **separate and independent legal entity** from the directors.

- Further Ld. Council of petitioner contended that the impugned order is unsustainable in law as the Trial Court failed to appreciate that there were **no allegations against petitioners in the plaint** and a bare reading of the plaint would show that Plaintiff was seeking to recover an amount, which was allegedly given to the Company at the highest, at the request of the said Defendants.
- There was **no contract between the petitioner and respondent** as the alleged loan was given by an Account Payee cheque in favour of the Company.
- It was contended that **Directors** of the Company **cannot be made personally liable for the outstanding dues and liabilities** of the Company, **unless** they have given **a guarantee, indemnity etc. or there are allegations of fraud** etc.
- Trial Court failed to appreciate that **liability of a Director of a Company, under law, is confined in case of malfeasance and misfeasance** and/**or the actions** of the Directors amount to an act **under the law of tort** towards those whom they owe a duty to care i.e. discharge fiduciary obligations.
- Further contended that the presence of petitioners was not required for adjudicating the disputes between Plaintiff and the Company and therefore they are neither necessary nor proper parties and ought to have been deleted from the array of parties on an application filed by them on the principles underlying the provisions of Order I Rule 10 CPC.
- In any event, an **apprehension of being unable to execute a decree in future is not a good enough reason, in law**, to make the existing or erstwhile Directors party to the suit, by lifting the corporate veil.

Held

- The doctrine of lifting of corporate veil (doctrine) is an exception to the principle that a Company is a legal entity, separate and distinct from its shareholders, with its own legal rights and obligations. It discards the separate entity of the Company and attributes the acts of the Company to those who are in direct control of its operations
- Further referred judgement[2] wherein **six principles** were crystallized for applying the said doctrine which are as follows:

  (i) ownership and control of a company were not enough to justify piercing the corporate veil;

  (ii) the Court cannot pierce the corporate veil, even in the absence of third-party interests in the company, merely because it is thought to be necessary in the interests of justice;

  (iii) the corporate veil can be pierced only if there is some impropriety;

2. In *Ben Hashem vs. Ali Shayif (2008) EWHC 2380 (Fam)*

(iv) the impropriety in question must be linked to the use of the company structure to avoid or conceal liability;

(v) to justify piercing the corporate veil, there must be both control of the company by the wrongdoer(s) and impropriety, that is use or misuse of the company by them as a device or facade to conceal their wrongdoing; and

(vi) the company may be a 'facade' even though it was not originally incorporated with any deceptive intent, provided that it is being used for the purpose of deception at the time of the relevant transactions.

- Further stated that, it has to be borne in mind that the **doctrine of Lifting of Corporate veil** is **not available in every case of alleged liability** against a Company. It is only **available in restricted cases and limited circumstances**, where it is permissible to so do under a Statute or where the **corporate structure** has been **instituted to perpetuate a fraud or is a camouflage, facade or sham to avoid liability** or in a case where **effect has to be given to a beneficial Legislation**. These can be broadly outlined as instances where the corporate veil can be lifted, though it cannot be said that this is an exhaustive list.

- **Allegations in plaint** do **not refer** to any **transaction with petitioners** in their **personal capacity** apart from stating that they were known to the Plaintiff in a friendly capacity. Although it is claimed that the money was advanced as loan due to personal relation with petitioners, it is undisputed that the **transaction was directly with the Company** and loan was advanced in the name of the Company by a cheque.

- There is **no allegation of fraud levelled against petitioners** and **nor** is there any **averment that the corporate structure was created as a mere facade or camouflage to avoid liabilities**. It is also not the case of the Plaintiff that the Directors were personal guarantors to the loan transaction or had assured to indemnify the amount.

- Learned counsel for the Respondent had also sought to argue that since petitioners have resigned, the decree, if passed in favor of the respondent, would be in executable. Suffice would it be to state in this regard that it is always open to summon the Directors as witnesses. In any case, the respondent is not remediless in executing the decree against the Company and as pointed out by counsel for petitioners, Respondent had already filed an application under Order XXXVIII Rule 5 CPC, which is pending adjudication before the Trial Court.

- The **averments** made in the plaint, in my view, **do not justify the lifting of the corporate veil to make the Directors personally liable**. The cryptic observation of the Trial Court, that the **facts and circumstances of the case attract the principle of lifting the corporate veil, is not supported by the pleadings** and I may also note that the order does not even give any reasons for having so held.

- The **impugned order is totally unsustainable**. The Trial Court has without any reasoning, declined to delete petitioners name against the well settled law on lifting the corporate veil. This is a clear material irregularity
- In view of the above, **present Revision Petition is allowed**. The order of the Trial Court dated 27.07.2018 is hereby **set aside and name of petitioners are deleted from the array of parties in the suit**. The Trial will henceforth proceed accordingly.

SEBI

Order of Adjudicating Officer of Securities and Exchange Board of India

Name of the Case: In respect of Mr Rajesh Bhatia and Geeta Bhatia under section 11(1), 11(4), 11(4A), 11B (1) and 11B (2) of the Securities Exchange Board of India Act, 1992 in the scrip of Tree House Education and Accessories Limited

Facts of the case

1. Pursuant to complaint(s) received in respect of merger between Tree House Education and Accessories Limited (hereinafter referred to as "**THEAL/ the Company**") and Zee Learn Limited (hereinafter referred to as "**ZLL**") alleging *inter alia* irregularities committed pertaining to the said merger plans between THEAL and ZLL and insider trading by promoters etc., the Securities and Exchange Board of India (hereinafter referred to as "**SEBI**") conducted investigation into trading activities in the scrip of the *Company* during the period of November 30, 2015 to December 04, 2015 (hereinafter referred as "**the Investigation Period**"). The shares of the *Company* are listed on the BSE India Limited (hereinafter referred to as "**the BSE**") & the National Stock Exchange of India Limited (hereinafter referred to as "**the NSE**" and the BSE and the NSE collectively referred to as "**the stock exchanges**").
2. Mr. Rajesh Doulatram Bhatia (hereinafter referred to as "**the Noticee no. 1**") and Ms. Geeta Rajesh Bhatia (hereinafter referred to as "**the Noticee no. 2**") were Managing Director and Non-Executive Director respectively, and were also promoters of the *Company*. Both of them were part of the management of the *Company* during the Investigation Period.
3. *Noticee no. 1* had a meeting with Mr. Subhash Chandra Goel on November 30, 2015. In that meeting Mr. Subhash Chandra Goel agreed to buy a total number of 40 Lakh shares of the *Company* for a total consideration of INR 80.20 Crore. Mr. Chandra had at that time also offered to merge the two companies i.e., THEAL and ZLL. Further, the *Company* vide its letter dated March 11, 2017 to the BSE has, *inter alia*, submitted that "I *(Mr. Rajesh) state that during November 2015 had a meeting with Mr. Subhash Chandra Goel through one Mr. Ganesh of Inga Capital wherein, Mr. Subhash Chandra Goel had discussed the possibility of merger of his company Zee Learn Ltd. with Tree House for the share exchange ratio of 53 shares of Re. 1/- each of Zee Learn Ltd with 10 shares of Tree House."* Shares were sold on December 03, 2015 in the Block Deal segment of the stock exchanges, which require certain meeting of mind between the buyer and seller for a trade

to get executed, this substantiates the submission that those 6 buyers entities were of Mr. Subhash Chandra Goel, who were aware that the *Noticees* would be placing sell order of 40 Lakh shares of the *Company.* After the transaction for sale and purchase was completed on December 03, 2015, Mr. Subhash Chandra Goel called the *Noticee no. 1* and again inquired whether the two companies can come together for their mutual business interest

4. Further SEBI found that on December 04, 2015, before market hours, the *Company* made a corporate announcement relating to merger between THEAL and ZLL. The price of the scrip of the *Company* witnessed a rise from a closing price of INR 202.40 on December 03, 2015 to the closing price of INR 222.60 on December 04, 2015 i.e., an increase by 9.98% in one trading day. In terms of regulation 2(1)(n) of the PIT Regulations, prior to its disclosure to the stock exchanges on December 04, 2015, the aforesaid corporate announcement by the *Company* relating to consolidation / merger options with ZLL was an Unpublished Price Sensitive Information (hereinafter referred to as "**UPSI**").

5. SEBI further stated that prior to its disclosure of the Price Sensitive Information (hereinafter referred to as "**PSI**") to the stock exchanges on December 04, 2015, it is noticed that both the *Noticees* being insiders had traded in the scrip of the *Company* when/while in possession of UPSI

6. SEBI further noted that The *Noticees* had obtained pre-clearance (on December 02, 2015) of trades executed by them on December 03, 2015 and are therefore, alleged to have given incorrect declaration to the *Company* regarding non possession of UPSI for the purpose of obtaining preclearance.

Charges levied

1. Indulging in trading in the scrip of the *Company* while in possession of UPSI prior to disclosure of the said PSI through announcement on the stock exchanges are alleged to be in violation of regulation 4(1) of the PIT Regulations and Section 12A(d) & (e) of the SEBI Act.

2. *Noticee no. 1* being in possession of the UPSI is further alleged to have communicated the same to his wife i.e., the *Noticee no. 2* and thereby has acted in violation of regulation 3(1) of the PIT Regulations.

3. Taking pre-clearance on the basis of incorrect declaration violation of Clause 6 of the Minimum Standards for Code of Conduct to Regulate, Monitor and Report Trading by Insiders as specified in Schedule B read with regulation 9(1) of the PIT Regulations.

Arguments made by Noticees

1. **Sale of shares was for repayment of bank loan:** Noticees submitted that the sale of 40 Lakh shares of the *Company* was altogether a different transaction unrelated to the merger talks for which appropriate disclosure on the stock exchanges was made. The said sale was made only with the purpose to repay the loan due to the banks.

2. **No UPSI in existence when shares were sold under block deal:** Noticees argued that there was no UPSI in

existence either on December 02, 2015 or December 03, 2015 when 40,00,000 shares were sold under Block Deals. Proposal of merger was mooted by Mr. Subhash Chandra Goel only after ZLL /Subhash Chandra Goel acquired 40,00,000 shares approx. 9% stake in the *Company*.

3. **Person in possession of positive UPSI will not sell shares:** *Noticees* submitted that if they were in possession of the UPSI about the possibility of the merger, they would have delayed the sale by a few days so as to fetch a higher price, as is evident that delay of sale by few days could have fetched an additional sum of INR 17 Crore (considering the price rose from INR 200 to INR 240 within 3 days of the announcement) to them. Noticees further stated that it is rather counter intuitive for a person in possession of UPSI to sell shares when the effect of UPSI upon publication is such that it would result in increase in price of shares.

4. **Buyers of shares are not charged with insider trading:** Noticees argued that in case UPSI was in existence at the time when 40 Lakh shares were sold, the buyers of the shares would also be aware of and in possession of UPSI. Therefore they would also be insider as per the definition of 'insider' under the PIT Regulations. The very fact that SEBI has not issued any SCN to the buyers after completing the investigation, clearly suggests that upon completion of investigation, Zee group/6 entities who bought the shares were not found to be in possession of UPSI. Therefore, it cannot be alleged that there existed any UPSI before December 04, 2015.

Arguments accepted by SEBI and conclusions made by SEBI

1. **Sale of shares was for repayment of bank loan:** SEBI on perusing the copies of the letters issued by the lenders stated that it can be seen that out of 4 lenders, 2 lenders had asked that the margin short fall in the credit extended by them can either be made up by pledging /mortgaging additional shares / unit, while the remaining 2 lenders had called upon the outstanding amount to be paid immediately. Further SEBI noted that it is also noted that the 2 lenders which provided an option to the *Noticees* to make up the margin shortfall through pledge of additional securities had asked the *Noticees* to do the same on or before December 01, 2015, whereas the *Noticees* herein are found to have sold their shares on December 03, 2015, i.e., two days after the above target date fixed by the aforesaid 2 lenders. In this regard, SEBI further noted that as submitted by Noticees the total outstanding amounts payable were INR 64 Crore, out of which the total loan amount demanded for immediate repayment by the 2 lenders referred to above was to the tune of INR 32.75 Crore only.

   SEBI stated that the Noticees could have sold shares that would have fetched sales proceeds to the extent of around INR 32.75 Crore and pledged additional shares with the other two lenders who wanted the *Noticees* only to recoup the margin shortfall in the loan amount outstanding against the *Noticees*. Further SEBI noted that the *Noticees* have not put forward any justification as to why they sold 40 lakh shares to the tune realizing sales proceeds of INR 80

Crore which was far in excess of the actual amount recalled by the 2 lenders referred to above and even far in excess of the total liability of INR 64 Crore outstanding towards all the 4 lenders.

SEBI further observed that the money realized by them from sale of shares was utilized to meet Noticees personal liabilities. This can be seen from the bank account statement of the *Noticee no. 2*, wherein sale proceeds in respect of aforesaid trades executed on behalf of the *Noticee no. 2* by the *Noticee no. 1* were immediately transferred to the account of the *Noticee no. 1*. All these facts clearly establish the communication of information by the *Noticee no. 1* to the *Noticee no. 2*. In view of the same, I reject the contention of the *Noticees* that the sale of shares by them was not a profitable event/ exercise but it was done to repay bank loans. The facts of the matter however clearly indicate that the *Noticees* have indeed got enriched out of the said sale transactions.

2. **No UPSI in existence when shares were sold under block deal:** In this regard SEBI stated that *Noticees* have disputed being in possession of UPSI at the time when the trades in the shares of the *Company* were executed on their behalf on December 03, 2015 which means, the *Noticees* want to state that no discussions on possible consolidation/merger with THEAL took place on November 30, 2015 which is not acceptable since Noticees have themselves submitted that the issue of proposed consolidation/merger between ZLL and THEAL was discussed on November 30, 2015 that necessitated subsequent public disclosure by the *Company* by way of corporate announcement on December 04, 2015 (at 08:48 hrs.).

Further the claim of the *Noticees* that the issue of merger was mooted only after their sale of 40 Lakh shares took place on December 03, 2015, sounds absurd, self-contradictory and misplaced. SEBI further highlighted the fact that *Noticee no. 1*, while proposing a consolidation of ZLL with THEAL at the meeting of Board of Directors of THEAL held on December 4, 2015, *inter alia,* apprised the Board of Directors of the *Company* that ZLL is emerging as a strong and promising market player and the proposed consolidation can prove to be beneficial to both the companies and would lead to significant contribution to the education industry. Also SEBI highlighted the fact that share exchange ratio as was discussed in the discussion held on November 30, 2015 between Noticee no. 1 and Mr. Subhash Chandra Goel was approved by the Board of Directors.

SEBI noted that The *Noticees* have no explanation to offer to establish as to how a PSI which according to them was not in existence as on the date of execution of their sale trades on December 03, 2015 (disregarding the fact that the said PSI originated on November 30, 2015 out of the meeting held by the *Noticee no. 1* with ZLL), got crystalized as a corporate announcement so fast (on December 03 2015) that the *Company* had to make an announcement in the early morning of December 04, 2015 i.e., before the commencement of market hours on the next trading day.

So SEBI held that it is irrefutable that the discussion about the possible consolidation/merger of ZLL with THEAL actually commenced with the meeting held by the *Noticee no. 1* himself on November 30, 2015 which finally culminated with a public disclosure on December 04, 2015. So Noticees were in possession of UPSI when they sold shares of the Company and consequently the declaration given by Noticees for taking pre-clearance also becomes incorrect.

3, Person in possession of positive UPSI will not sell shares:

SEBI held that this defense put forward by the *Noticees* is found to be grossly untenable and lacks merit. SEBI further held that it is pertinent to observe that regulation 4(1) of PIT Regulations nowhere envisages that the alleged insider trade should essentially result in profit to the insider so as to establish the charge of insider trading.

SEBI stated that Regulation 2 (1) (n) of PIT Regulations while dealing with the definition of 'UPSI' **envisages that the subject information upon becoming generally available, is likely to materially affect the price of the securities of the company.** Such effect on the price of the securities can be negative as well as positive. Since the movement in the price of any scrip on any given trading day depends on interplay of multitude of market factors, both domestic as well as global factors and the expectation of movement of price of a scrip also varies person to person, it can be possible that the price of the scrip of a company may not witness any material change at all despite there being a public announcement of a PSI. The definition of 'UPSI' does not pre-suppose that a PSI to become an 'UPSI' should essentially result in upward movement in the price of the scrip.

SEBI further highlighted that after the sale of those 40 Lakh shares by the *Noticees* on December 03, 2015, the *Company* could not sustain the price level at which the said shares were sold by the *Noticees*. Thus, it cannot be a case of the *Noticees* that post the public announcement made by the *Company* about the proposed consolidation/merger with ZLL, the market price of its shares went up and sustained a rising trend over a long period so as to claim that they have indeed suffered huge amounts of losses, albeit notionally, by selling the shares prior to the said public disclosure. Therefore, the contention of the *Noticees* that they had incurred a notional loss of INR 8-17 Crore is baseless and has been advanced as an afterthought argument after having witnessed the positive reaction of the market to the said corporate announcement triggering upward movement in the price of the scrip.

4. Buyers of shares not charged with insider trading:

SEBI submitted that *Noticees* on the one hand have advanced arguments that their sale trades had no relation with the proposed merger of ZLL with THEAL, whereas on the other hand they have claimed that although the counter party buyers to their trades were connected to ZLL and Mr. Subhash Chandra Goel, yet they have not been proceeded against in the present

proceedings. In fact, the *Noticees* vide their letter dated May 29, 2019 have categorically stated that they were not knowing and/or associated/related/ connected to the counter party buyers. Given the aforesaid continuous flip-flop stand adopted by the *Noticees* vis-a-vis their counter party buyers or their broker, sometime saying that they knew that the six counter party buyers are connected with Mr. Subhash Chandra Goel, sometime stating that they did not know these counterparty buying entities at all and sometime that their trades were totally indifferent to the talk/meeting held on November 30, 2015 , it shows the *Noticees* are only trying to mislead the proceedings by making contradictory and inconsistent affirmations from time to time. Under the circumstances, I find that the demand of the *Noticees* that simply because their counter party buyers have not been proceeded with, the serious charges of insider trading levelled against them should be dropped is completely devoid of substance and merit.

Held by SEBI

Entity	***Provision of Law violated***	***Penalty levied under Section***	***Penalty***
Rajesh Bhatia For Leaking UPSI and insider trading	Regulations 3(1) and 4(1) of SEBI (PIT) Regulations, 2015 and Section 12A (d) & (e) of the SEBI Act, 1992	15G	15,00,000
Geeta Bhatia For Insider Trading	Regulation 4(1) of SEBI (PIT) Regulations, 2015 and Section 12A (d) & (e) of the SEBI Act, 1992	15G	10,00,000
Rajesh and Geeta Bhatia Taking pre-clearance on the basis of incorrect declaration	Clause 6 of the Minimum Standards for Code of Conduct to Regulate, Monitor and Report Trading by Insiders specified in Schedule B read with regulation 9(1) of SEBI (PIT) Regulations, 2015	15HB	Rs 300,000 each

Cases referred:

Noticees:
Dilip S. Pendse v SEBI (Appeal No. 80 of 2009, decided on November 19, 2009)

Mrs. Chandrakala vs. SEBI (Appeal No. 209 of 2011, decided on January 31, 2012)

SEBI:
Systematix Shares & Stocks India Limited v. SEBI (2012)

Mr. Kolla Koteswara Rao – Suspended Director of the Corporate Debtor (Appellant) vs. Dr. S.K. Srihari Raju-Financial Creditor (Respondent 1) Anjaneyulu Sadhu –RP (Respondent 2) **– in the order dated 26 March 2021 passed by the National Company Law Appellate Tribunal, (NCLAT) New Delhi**

Facts of the Case

- The Corporate Debtor- Leesa Lifesciences Private Limited was allotted an industrial land by Telangana State Industrial Infrastructure Corporation (TSIIC) to setup a bulk drug unit, for which the corporate debtor availed facility from the State Bank of India (the lender) for an amount of Rs. 21.50/- Crores. The corporate debtor defaulted in repaying the facilities as per the agreed repayment schedule and the lender classified the loan account as a Non-Performing Asset (NPA)
- A One-Time Settlement (OTS) agreement dated 30th November, 2017 was entered into between the lender and the Corporate Debtor for an amount of ₹ 11.73 Crores approx, the terms of which stipulated that 20% of the OTS was required to be deposited by 12th December,2017 and the balance amount within 6 months' from the date of letter.
- The Corporate Debtor and the first respondent entered into an agreement of sale on 10th December, 2017 pursuant to which the Corporate Debtor agreed to sell to the first respondent the land allotted by TSIIC together with the structure on the property and the plant and machinery for same consideration that was agreed between the parties to be the OTS amount payable to the lender.
- The first respondent paid an amount of ₹ 2.34 Crores, on behalf of the corporate debtor to the lender.
- As per the terms of the agreement the Corporate Debtor was required to obtain all necessary permissions including No-Objection Certificate (NOC) from TSIIC and if the corporate debtor had failed to do so, the corporate debtor had to indemnify the first respondent.
- TSIIC cancelled the allotment vide letter dated 9th February, 2018 as the corporate debtor failed to commence the project in time and as no permission from TSIIC was obtained the time under OTS offer letter also expired on May 2018.
- A notice was issued by the first respondent to the Corporate Debtor in October, 2018 seeking repayment of the amount of Rs. 2.35 Crores paid by the first respondent of the lender on behalf of the corporate debtor along with interest @ 24% per annum as agreed under the agreement.
- The first respondent approached National Company Law Tribunal (NCLT) for initiating Corporate Insolvency Resolution Process (CIRP) against the Corporate Debtor u/s 7 of Insolvency and Bankruptcy Code, 2016 (Code).
- The application was admitted at NCLT and an order of Moratorium was passed after deliberating that the amount paid by the first respondent on behalf of the corporate debtor to the Lender for compliance of the OTS would fall within the definition of financial debt under the Code.
- An appeal by filed at NCLAT by the suspended director of the Corporate Debtor against the admission of the said application.

Arguments by the Appellant

- The first respondent does not fall within the meaning and **definition of**

a financial creditor as it is a settled law that a **financial creditor is a person who is directly engaged in the functioning of the corporate debtor and is involved right from the beginning in assessing the viability of the corporate debtor and would be engaged in the restructuring of the loan as well as the reorganization of the corporate debtor business when there is financial stress**

- The amount **was not paid for 'time value of money'**; because had the property eventually culminated into a sale, the money would not have accrued interest and would not have been payable
- The money was not utilized by the second respondent but was paid to the lender as per the terms of the agreement
- The utilization of money by the corporate debtor was a sine qua non, **the fact that the money was not utilized by the corporate debtor itself implies that the disbursal does not fall within the realm of financial debt.**
- There **was no date of default mentioned in the application and hence the application was non-maintainable**
- The **resolution professional did not make any profit by way of this transaction and therefore, the transaction cannot be said to have a commercial effect of borrowing and therefore was not in the nature of a financial debt**
- No Notice was issued prior to filing of the application u/s 7 of the code

Arguments by the first respondent

- A financial debt is a debt, against 'consideration for time value of money', and debt includes a 'claim' which is a right to payment or a right to remedy for breach of contract
- Though money was paid under an agreement of sale, the same was paid by the first respondent to the lender on behalf of the corporate debtor which was to be repaid by the corporate debtor along with interest in the event the transaction did not materialize and **hence it was in the nature of a debt which was disbursed for the 'time value of money**
- A right to payment accrued to the first respondent as per the terms of the agreement. As the corporate debtor could not procure the NOC from TSIIC, which was a mandatory requirement for transfer of the said land in favour of the financial creditor, he corporate debtor had to repay the amount paid by the financial creditor to the lender on its own behalf along with interest
- The transaction was for transfer of assets of the corporate debtor and was within the definition of 'transaction' as defined u/s 3(33) of the Code that there is no requirement to issue notice to corporate debtor for default u/s 7 of the Code and even otherwise the first respondent delivered a proper notice to the Corporate Debtor

Arguments by the Resolution Professional

- There is no provision in the entire Code or its rules and regulations which mandate service of advance notice by a financial creditor prior to instituting a petition u/s 7 of the Code
- The agreement to sell stated that the financial creditor was required make the payment of consideration directly to

the lender towards the amount payable under the OTS and no amount would be payable directly to the corporate debtor .In the present case the entire agreement is a nullity if the corporate debtor failed to either get NOC or sell the land

- Placing reliance on Section 32 of the Indian Contract Act, 1872, (Contract Act) in support of contention that the Contingent Contract mandatorily requires NOC from TSIIC and since the first limb of the Contract dated 10th December, 2017 was impossible to perform as the allotment was cancelled, the same was void *ab initio*
- Further, Section 35 of the Contract Act, became applicable as the corporate debtor failed in performing its reciprocate promises **and cannot seek shelter stating that the 'debt' which has the 'commercial effect of borrowing' is not a 'financial debt'**

Held

- NCLAT observed that that issuance of Notice prior to Section 7 Application is not mandatory as per the provisions of the Code as noted by the Hon'sble Supreme Court in ***'Innoventive Industries Ltd.' vs. 'ICICI Bank and Anr.' (2018)***
- Also noted that the contention of the Learned Counsel appearing for the Appellant that the money was not utilized by the Corporate Debtor, but paid to the lender and as the utilization of money by the 'Corporate Debtor' is a sine qua non and therefore, the 'debt' does not fall within the definition of 'Transaction' as defined under Section 3(33) or under 'Financial Debt' as defined under Section 5(8)(f), is untenable.
- NCLAT also noticed that the agreement to sell started from the OTS entered into between the corporate debtor and the lender and it is only in lieu of the consideration paid by the first respondent to the lender on behalf of the Corporate Debtor, that the agreement of sale for the subject property was executed & in case of failure to execute & register the deed 24% p.a. interest was required to be paid. This established the fact that the 'debt' satisfied the threefold criteria- disbursal, time value of money & Commercial effect of borrowing. Therefore the ratio laid down by the Hon'ble Apex Court with respect to 'financial debt' in *'Pioneer Urban Land and Infrastructure Ltd. & Anr.' (Supra)* is squarely applicable to the facts of this case.
- Also observed that Section 5(8) of the code is a 'Residuary Provision' which is catch all in nature and the amounts that are raised in transactions would amount to a 'Financial Debt' if they had 'a commercial effect of borrowing'
- It was also noted that specific intention of the first respondent was to take over the land with the structure and the plant and machinery so as to commence the business for which purpose the land was initially allotted by TSIIC.
- Keeping in view the facts of the attendant case, it was considered opinion that the 'debt' is a 'Financial Debt' and the first Respondent a 'Financial Creditor' and the appeal was dismissed

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