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Article

Winding Up – Legal position under Companies Act, 2013 vis-à-vis Insolvency and Bankruptcy Code, 2016

By **Aman Parnami**

Preamble

Prior to November 15, 2016, the term "winding-up" was neither defined under the Companies Act, 1956 ("1956 Act") nor under the Companies Act, 2013 ("2013 Act").

Section 255 of the Insolvency and Bankruptcy Code, 2016 ("the Code") has been notified with effect from November 15, 2016 and by virtue of Section 255, the 2013 Act stands amended in accordance with Schedule XI of the Code. The aforesaid Schedule XI now defines the term "winding up" by introducing a new Section 2(94A) to the 2013 Act as *"winding up under this Act or liquidation under the Insolvency and Bankruptcy Code, 2016."* On a bare reading of the definition, it shall be safe to conclude that winding up proceedings will now be governed by the provisions of 2013 Act as well as the Code. The other significant changes introduced by the Code to the 2013 Act include removal of provisions of 'voluntary winding up' and winding up on the ground of 'inability to pay debts' from the 2013 Act as the proceedings relating to these now find place under the Code.

Subsequent to the notification of Section 255 of the Code, the Ministry of Corporate Affairs ("MCA"), through its Notification dated December 07, 2016, has notified the provisions of Chapter XX of the 2013 Act with effect from December 15, 2016. These provisions relate to winding up of companies on any ground other than inability to pay debts i.e. on any of the circumstances mentioned under Section 271(a) to (e) of the 2013 Act (as discussed hereunder).

This article summarizes the current legal position for different modes of winding up of a company pursuant to the notifications pertaining to enforcement of provisions of Section 255 of the Code and Chapter XX of the 2013 Act, dated November 15, 2016 and December 07, 2016, respectively.

Position prior to November 15, 2016

The provisions for winding up provided in Chapter XX of the 2013 Act are divided into four parts:

- Part I dealing with the provisions for winding up by the National Company Law Tribunal ("Tribunal");
- Part II (Sections 304-323) dealing with the provisions for voluntary winding up;
- Part III dealing with provisions applicable to every mode of winding up; and
- Part IV dealing with appointment of official liquidator.

The abovementioned provisions, although provided in the 2013 Act, were never notified. Therefore, prior to November 15, 2016,

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winding up through any mode, i.e. voluntary winding up and winding up by Tribunal, was governed by the provisions of 1956 Act.

Position after November 15, 2016

- *Winding up on inability to pay debts*

Section 271(1)(a) of 2013 Act which dealt with the winding up by Tribunal on account of inability to pay debts has been omitted by Section 255 of the Code. The same is now dealt with in accordance with the provisions of Sections 7 to 9 of the Code, being initiation of corporate insolvency resolution process by financial and operational creditors.

An application to the adjudicating authority (being the Tribunal) for initiation of corporate insolvency resolution process can be made only when there is a "default" in payment of debt by a corporate person. In this regard, it is to be noted that the term "default" has been defined in the Code to mean non-repayment of a debt, whether whole or in part, which has become due and payable by a corporate person. This would imply that, now under the Code, insolvency resolution proceedings can be initiated even against a financially solvent company having made a default in payment of its debts, since the same would fall within the purview of "default" under the Code. Once the application for initiation of corporate insolvency resolution process is made and the same is accepted by the Tribunal, an insolvency professional is appointed for conducting the corporate insolvency resolution process. The process is required to be completed within 180 days from the date of admission of application by the Tribunal, on failure of which, Tribunal may pass an order for liquidation of the corporate person in relation to whom the application was made.

Under the erstwhile regime, winding up applications could be made on account of "inability to pay debts". The expression "inability to pay debts" has been interpreted by Andhra Pradesh High Court in the case of *Reliance Infocomm Limited* v. *Sheetal Refineries Private Limited*[1], to mean a situation where a company is commercially insolvent, i.e. the existing and provable assets would be insufficient to meet the existing liabilities.

Therefore, a remedy to initiate winding up proceedings against financially solvent companies that had defaulted in payment of debts was not available under the earlier regime. However, this is now feasible under the Code.

- *Winding up on grounds other than inability to pay debts*

The circumstances under which a company can be wound up by Tribunal have been clearly enlisted in Section 271 as follows : (a) passing of special resolution to that effect; (b) acting against the sovereignty and integrity of India, security of state, friendly relations with foreign states, public order, decency or morality; (c) conducting affairs in a fraudulent manner; (d) default in filing of financial

[1] 142 Comp. Cas 170 (AP)

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statements or annual returns with the Registrar for immediately preceding five financial years; and (e) on just and equitable grounds in the opinion of Tribunal.

The above sub-section (d) relating to winding up on non-filing of financial statements and annual returns of preceding five years has been introduced in the 2013 Act and was not provided in the 1956 Act. Earlier, the remedy available with the Registrar for non-filing of financial statements and annual return by a company was to declare such company as a defunct company and strike off the name of such company from the register of companies. Now, the same has also been introduced in the 2013 Act as a ground for winding up.

The aforesaid provisions stand notified with effect from December 15, 2016, therefore the winding up applications on any of the grounds specified above will be made to the Tribunal in accordance with the provisions of 2013 Act.

- *Voluntary winding up*

The provisions of voluntary winding up provided under the 2013 Act presently stands omitted due to the notification of Section 255 of the Code. However, these provisions now fall within the purview of Section 59 of the Code which deals with the voluntary liquidation of corporate persons – this Section is yet to be notified.

Therefore, in view of non-notification of the provisions of voluntary liquidation under the Code, the question which arises is regarding provisions which will be applicable for voluntary winding up of companies and the manner in which the same will be dealt with.

The answer to the above can be derived from Section 468(3) of the 2013 Act which provides that with respect to winding up, any rules framed by the Hon'ble Supreme Court at any time before the commencement of 2013 Act shall continue to be in force till the time new rules are framed to that effect by the Central Government and any reference to the High Court in those rules shall be construed as the reference to the Tribunal.

The Tribunal shall not have the authority to entertain applications with respect to voluntary winding up till the notification of provisions of voluntary winding up under the Code. Therefore, till the time such provisions are notified and corresponding Rules are prescribed by the Central Government, the procedure laid down under the Companies (Court) Rules, 1959 ("Court Rules"), being the rules framed by Hon'ble Supreme Court, will be applicable and consequently to the extent Court Rules refer to the provisions of 1956 Act, such provisions will be applicable to the applications of voluntary winding up. Therefore, as on date, all the applications or petitions pertaining to the voluntary winding up shall continue to be made to the High Court of competent jurisdiction.

Transfer of winding up proceedings from High Court to Tribunal

Along with the Notification dated December 07, 2016, MCA on the same date issued the Companies (Transfer of Pending Proceedings) Rules, 2016 ("Rules") for clarifying the

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ambiguities relating to transfer of pending proceedings from a High Court to the Tribunal. The same can be summarized in the following manner:

- *Winding up proceedings pending before High Court on ground of inability to pay debts*

All the proceedings pending before the High Courts on December 15, 2016, and the notice of which have not been served on the respondent, shall be transferred to the respective Bench of the Tribunal exercising territorial jurisdiction over the concerned State and shall be dealt in accordance with the provisions of the Code.

- *Winding up proceedings pending before High Court on grounds other than inability to pay debts*

All the proceedings pending before the High Courts on December 15, 2016 and the notice of which have not been served on the respondent, shall be transferred to the respective bench of the Tribunal exercising territorial jurisdiction over the concerned State and shall be dealt in accordance with the provisions of 2013 Act.

- *Winding up proceedings pending before High Court relating to voluntary winding up*

All the proceedings pending before the High Courts till April 1, 2017, shall continue to be dealt with by the High Courts in accordance with the provisions of 1956 Act.

The Hon'ble Bombay High Court, in the case of *West Hills Realty Private Ltd. and Ors* v. *Neelkamal Realtors Tower Private Limited,*[2] has further clarified that only the petitions which are at a pre-admission stage and have not been served on the respondent, will be transferred to the Tribunal. Petitions for which only the notice of hearing of the petition before the Court has not been served, will not be transferred to the Tribunal. Therefore, such petitions will continue to be dealt with by the High Courts.

In light of the aforesaid, it can be concluded that pending proceedings for both winding up on inability to pay debts and winding up on grounds other than inability to pay debts will be transferred to Tribunal. Although the former category will be governed by the provisions of the Code, the latter category will be governed by the provisions of 2013 Act. Pending proceedings for voluntary winding up will continue to be dealt by the High Courts in accordance with the provisions of 1956 Act and the procedure prescribed under the Court Rules.

Conclusion

Though the much-awaited sections of the 2013 Act pertaining to winding up of companies on grounds other than inability to pay debts were made effective from December 15, 2016, the final Rules for the same are yet to be notified. Therefore, in view of provisions of Section 468(3) of the 2013 Act pertaining to applicability of the Court Rules, till the

[2] MANU/MH/2758/2016 decided on December 26, 2016

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time Rules are prescribed by the Central Government, under the current scenario, an application for winding up on these grounds will be made before the Tribunal and the same will be dealt with in accordance with the procedure prescribed under the Court Rules.

The fresh applications for initiation of corporate insolvency resolution process on grounds of "default" under the Code shall be made before the Tribunal in accordance with the procedure prescribed under the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, notified with effect from December 01, 2016.

In view of the above, the current position with respect to different modes of winding up can be summarized as under:

S.No	Mode of winding up	Applicable law	Applicable Rules / Regulations
1.	Corporate insolvency resolution process on committing "default" (erstwhile winding up on inability to pay debts)	Code	Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016
2.	Winding up on grounds other than inability to pay debts	2013 Act	Court Rules
3.	Voluntary winding up	1956 Act	Court Rules

There is a possibility that disposal of winding up applications, on account of inability to pay debts made to the High Courts before December 15, 2016 and transferred to the Tribunal, under the Code can be a more time consuming process as no company can be directly wound up under the Code, i.e. every proceeding has to go through the corporate insolvency resolution process and consequent liquidation on failure of insolvency resolution process.

While, MCA seems to be in a hurry to shift the burden of corporate litigation from High Courts to the Tribunal, the same is not without hurdles. Another concern is the overburdening of the Tribunal due to existing litigations under 2013 Act, transfer of pending cases from the earlier authorities such as Company Law Board and the Board for Industrial and Financial Reconstruction. Therefore, in view of the above, it will be interesting to see how the Tribunal deals with fresh applications under the 2013 Act and the Code, pending[3] cases transferred from High Courts, Company Law Board and Board for Industrial and Financial Reconstruction.

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[3] As on March 2015, around 4200 cases were pending in CLB and 4500 winding up cases were pending in High Courts. (Source: *https://thewire.in/86871/insolvency-and-bankruptcy-code/)*

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Notifications & Circulars

Companies (Incorporation) Rules, 2014 amended: Ministry of Corporate Affairs ("MCA") by its Notification dated January 25, 2017, has amended the Companies (Incorporation) Rules, 2014. Firstly, the format of certificate of incorporation issued by the Registrar of Companies in Form INC-11 has been amended and shall now state the Permanent Account Number (PAN) of the company (issued by the Income-tax Department) along with its Corporate Identity Number (CIN). Corresponding changes have been made in Form INC-32 to include additional information for the purpose of applying for PAN and Tax Deduction Account Number (TAN). Form INC-32 was introduced to simplify and integrate the process of incorporation of a company.

Voluntary liquidation process - Draft Regulations issued: On February 14, 2017, the Insolvency and Bankruptcy Board of India (IBBI) has published draft Regulations applicable to the voluntary liquidation of corporate persons under Part II of the Insolvency and Bankruptcy Code, 2016 (IBC).

Section 59 of the IBC mandates a corporate person to meet such conditions and procedural requirements as may be specified by IBBI. A "corporate person" includes any company incorporated under the Companies Act, 2013, LLP incorporated under the Limited Liability Partnership Act, 2008 or any other person incorporated with limited liability under any law excluding a financial service provider. A corporate person other than a company, through its designated partners or any other persons responsible for exercising its corporate powers, shall be required to submit a declaration accompanied by an affidavit to initiate the process of voluntary liquidation.

Within four weeks of the declaration, a resolution would require to be passed to give effect to the commencement of the process of liquidation as well as the appointment of an insolvency professional. A corporate person shall cease to carry on its business from the date of passing of the aforesaid resolution (which shall be deemed to be the date of commencement of voluntary liquidation). The liquidator is required to make best endeavors to complete the liquidation process within one year from commencement of voluntary liquidation.

Mutual Fund investments in InvITs an REITs - SEBI (Mutual Funds) (Amendment) Regulations, 2017 notified: The Securities and Exchange Board of India ("SEBI"), has amended the SEBI (Mutual Funds) Regulations, 1996 on 15th February, 2017, by Notification bearing Ref # SEBI/LAD/NRO/GN/2016-17/031. Importantly, SEBI has capped the maximum investment permissible by a mutual fund in the units of a single issuer of REIT/InvIT. A mutual fund, under all its schemes, is not permitted to own more than 10% of units issued by a single issuer of REIT

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and InvIT. Further, a mutual fund scheme is not permitted to invest more than 10% of its Net Asset Value (NAV) in the units of REIT and InvIT and more than 5% of its NAV in the units of REIT and InvIT, issued by a single issuer. However, an exception has been made for index funds and sector or industry specific schemes for REIT and InvIT, to whom the above-mentioned limits shall not apply.

Additionally, for investment made in REIT/ InvIT by an existing Mutual Fund Scheme, SEBI has vide its latest Circular dated February 28, 2017, also mandated that current unit-holders of such Mutual Fund scheme be given a time period of at least 15 days for enabling them to exercise their exit option.

It may be noted that SEBI, in an earlier board meeting dated 14th January, 2017, had decided to permit investments by mutual funds in the units of Infrastructure Investment Trusts (InvITs) and Real Estate Investment Trusts (REITs). The present amendment to the Regulations is a follow up to that decision, which now provides mutual funds with an additional investment option by way of investment in the units of REITs and InvITs.

SEBI (Issue of Capital and Disclosure Requirements) (Amendment) Regulations, 2017 notified: SEBI, on 15th February, 2017, has amended the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 by Notification bearing Ref # SEBI/LAD/NRO/GN/2016-17/030. Now, under Regulation 70, preferential issue of shares made pursuant to a scheme approved by the National Company Law Tribunal (NCLT) shall not fall under the ambit of Chapter VII of the Regulations dealing with preferential issue. However, the pricing provisions under the said Chapter VII shall apply in case of allotment of shares only to a select group of shareholders or shareholders of unlisted companies made under such schemes. Further, after the amendments, provisions of Chapter VII of the Regulations shall not apply to a rehabilitation scheme approved by NCLT under the Insolvency and Bankruptcy Code, 2016.

These amendments also set out penal consequences for contravention of the Regulations. In the event any listed entity or any other person acts in contravention of the Regulations, then along with penalty prescribed, the respective stock exchanges may impose fines; suspend trading; freeze promoter/promoter group holding of designated securities, as may be applicable, in coordination with depositories; and any other action, as may be stipulated by SEBI. In case of non-payment of fine by the defaulting listed entity, any other action, in accordance with law, may also be taken by the concerned stock exchange, after giving a written notice to such defaulter.

SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, amended: The Securities and Exchange Board of India, through its Notification dated February 15, 2017, has notified the SEBI (Listing Obligations and Disclosure

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Requirements) (Amendment) Regulations, 2017, inserting a new sub-regulation 37(6) in the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

As per Regulation 37, every listed entity desirous of undertaking a scheme of arrangement or involved in a scheme of arrangement, is first required to file the draft scheme of arrangement *(proposed to be filed before any Court or Tribunal)* with the stock exchange to obtain its observation letter or no-objection letter. Only on obtaining such observation letter or a no-objection letter, can the scheme be filed before any Court or Tribunal, as the case may be.

Now, with this amendment, a draft scheme which solely provides for merger of a wholly owned subsidiary with its holding company can validly be filed before any Court or Tribunal, without first obtaining an observation letter or a no-objection letter from the stock exchange. However, such draft schemes are still required to be filed with the stock exchanges for the limited purposes of disclosure.

Integrated Reporting by listed entities: Currently, SEBI mandates the top 500 listed entities in India (based on market capitalization calculated as on March 31 of every financial year) to prepare a business responsibility report describing initiatives taken from an environmental, social and governance perspective (in accordance with Regulation 34(2)(f) of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015). SEBI has recently issued a Circular bearing reference No. SEBI/HO/CFD/CMD/CIR/P/2017/10, dated February 6, 2017, advising such top 500 listed entities to also adopt the principles of integrated reporting and prepare an 'Integrated Report' (IR) on a voluntary basis with effect from the financial year 2017-18.

SEBI has advised that information relating to IR may be provided as part of the annual report with a separate chapter on IR or by incorporating in management discussion and analysis or as a separate report. In case an organisation has already provided such information in any report as per national/international framework, an appropriate reference to such IR may be provided to avoid duplication of any information. Alternatively, an organisation may host their IR on their website and thereafter provide an appropriate reference to the same in their annual report.

The International Integrated Reporting Council (IIRC) – a global coalition of regulators, investors, companies and other stakeholders - has prescribed certain Guiding Principles for preparation of an IR, which SEBI also makes reference to. These Guiding Principles include *inter-alia* that an IR should (a) be concise, (b) focus on organizations' strategy and ability to create value in short term and long term, (c) be reliable and complete, (d) disclose material information, (e) be consistent with time and comparable with other organizations, (f) be a holistic depiction of interrelation and dependency between factors which affect

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the organizations' ability to create value (g) include nature and quality of organization's relationship with its stakeholders and how the organization takes into account the interest of stakeholders and responds to such legitimate needs and interests and (h) disclose the various forms of capital to investors.

The Circular is thus an attempt by SEBI to encourage India's largest organizations to voluntarily make additional disclosures relating to environment and corporate social responsibility, etc., in their annual report to stakeholders, thereby complying with international best practices of providing stakeholders with information useful in taking investment decisions.

Exchange Listing Control Mechanism – Procedures clarified: SEBI has issued a Circular dated January 27, 2017, on procedures for Exchange Listing Control Mechanism [SEBI/HO/MRD/DSA/CIR/P/2017/9] to address conflicts which might arise during the listing of a stock exchange on another recognized stock exchange, other than itself and its associated stock exchange. The Circular provides that the Listing Department of the listing stock exchange (i.e. stock exchange on which the listing is done) shall be responsible for monitoring the compliance of the listed stock exchange (i.e. stock exchange which is getting listed), as it does for listed companies.

At the second level, the Independent Oversight Committee (IOC) of the listing stock exchange shall deal with disputes, if any, between the listing and listed stock exchanges. The listed stock exchange, if aggrieved by the IOC's decision, may appeal to the Independent Conflict Resolution Committee (CRC) constituted by SEBI. The CRC shall also monitor any potential conflicts which might arise between the listed and listing stock exchange.

Regulation 45 of the Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012 (SECC) provides for listing of a stock exchange on another recognized stock exchange, other than itself and its associated stock exchange. It provides, *inter alia,* that the listed stock exchange should be compliant with the SECC provisions, should have completed 3 (three) years of continuous trading operations immediately preceding the date of application of listing, and should have obtained SEBI's approval.

SEBI's move of providing a clear and streamlined approach to cross-listing is timely and welcome, especially with the controversy surrounding listing of NSE on BSE and *vice versa.* It should be noted that SEBI has not allowed self-listing of a stock exchange whereas self-listing is a commonly followed practice globally (for instance, at Singapore and Hong Kong stock exchanges).

Issue of rupee denominated bonds overseas - Amendments: In a move to provide more choices of investors to Indian entities issuing Rupee denominated bonds abroad (also referred to as 'Masala Bonds'), the

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Reserve Bank of India ('RBI') vide its Circular 31 dated 16th February, 2017, bearing Ref # RBI/2016-17/233 (Circular 31), has now permitted Multilateral and Regional Financial Institutions where India is a member country, to invest in Rupee denominated bonds. Issuance of 'Masala bonds' is required to be within the extant aggregate limit of foreign investment permissible in corporate debt as notified from time to time (currently notified as INR 2443.23 billion).

This follows the numerous tax benefits and exemptions for investors investing in rupee denominated bonds issued by Indian entities, announced by the Government of India in the Union Budget 2017.

FDI policy on investment in stock exchanges relaxed: The Government of India has reviewed and revised Paragraph 5.2.21 of 'Consolidated FDI Policy Circular of 2016' (FDI Policy) relating to infrastructure companies in the securities market, by Press Note dated February 20, 2017. At present, foreign investment is limited to 49% in infrastructure companies in the securities market (namely in stock exchanges, commodity exchanges, depositories, and clearing corporations) and is subject to SEBI Regulations. Though the aforesaid FDI limit of 49% continues to apply, restrictions on investments through FII and FPI route have been removed.

All foreign investment in stock exchanges, including investment by FPIs shall now be subject to the provisions of the Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations 2012, SEBI (Depositories and Participants) Regulations, 1996 and any other guidelines/ regulations issued by the Central Government, SEBI and RBI from time to time.

It is to be noted that Regulation 17 of the Stock Exchanges Regulations, 2012 limits the investment in a stock exchange by a non-resident investor including persons acting in concert to 5% of the equity, provided that the foreign investment limit shall be 15% of the paid-up capital, in the event investment is made by a foreign stock exchange/depository/ banking company/ insurance company, either directly or indirectly, individually or together with persons acting in concert.

The changes made in the FDI Policy are in line with the amendments in the Stock Exchanges Regulation, 2012 notified by SEBI and corresponding amendments to FEM (Transfer or Issue of security by a Persons Resident outside India) Regulations, 2000 as notified by the RBI. *[Please refer, Corporate Amicus – February 2017 issue]*

FDI - Foreign Portfolio Investment (FPI) under Corporate Debt route: In October 2016, the Reserve Bank of India had permitted Foreign Portfolio Investors to invest in unlisted non-convertible debentures/bonds issued by Indian company as well as in securitized debt instruments, vide the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) (Twelfth

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Amendment) Regulations, 2016. Accordingly, to align the regulatory framework governing corporate debt, SEBI has effected relevant amendments by SEBI (Foreign Portfolio Investors) (Second Amendment) Regulations, 2017, notified on February 27, 2017. The revised provisions permit FPI investment in unlisted non-convertible debentures/bonds and securitized debt instruments including pass-through securities/certificates issued by securitization Special Purpose Vehicles (set up for securitization of assets with banks, financial institutions or NBFCs as originators). Previously, FPI investment permissible in unlisted debt securities was limited to securities issued by companies engaged in the infrastructure sector. Further, FPI investment was not permissible in securitized debt instruments. Therefore, the eligible investment instruments that are now available to FPIs stands enlarged.

Given that unlisted non-convertible debentures/ bonds issued by public or private Indian companies come under the regulatory purview of the Ministry of Corporate Affairs (MCA), FPI in unlisted debt securities is also subject to guidelines issued by MCA.

It may also be noted that in a welcome move, SEBI in its latest Circular dated February 28, 2017, has further clarified that the minimum 3-year residual maturity requirement shall not be applicable to FPI investment in securitized debt instruments. However, such 3-year residual maturity requirement shall apply to FPI investments in unlisted non-convertible debentures/bonds. Importantly, the maximum investment limits permissible for FPI investment in unlisted non-convertible debentures/bonds and securitized debt instruments has been set at INR 35,000 Cr (within the extant aggregate corporate debt limit of INR 2,44,323 Cr).

Ratio Decidendi

Breach of promise of 'assured returns' in a simple sale/purchase agreement of property would not qualify as 'financial debt' in absence of any consideration for time value of money

Key points:

- A forward contract to sell product at the end of a specified period - such as a contract for sale/purchase of property will be treated as a contract for sale of specified goods.
- 'Financial debt' includes such financial transactions which are usually for a sum of money received/invested today to be paid/repaid over a period of time in a single or series of payments in future. It is necessary that the inflows and outflows are distanced by time and there is a compensation for time value of money.

Facts:

The matter arose out of non-payment of amounts in the form of 'assured returns' by the respondents as per the agreement between the Applicants and the Respondent. The Respondent was engaged in the business of constructing, promoting and developing commercial and residential properties and

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office spaces. The Applicants had booked certain real estate units including office space, shops and residential flats with the Respondent. As per the 'Memorandum of Agreement' between the Respondent and the Applicants, the Respondent had promised to pay a fixed amount to the Applicant, on a monthly basis, until they received possession of the booked real estate units.

Contentions:

The Applicants contended that the Respondent qualified as a 'debtor' since he defaulted on the payment of 'assured returns' to the Applicants. 'Assured returns' would qualify as 'financial debt', thereby making the Applicants a 'financial creditor' and thus eligible to initiate Corporate Insolvency Resolution Process (CIRP) under the Insolvency and Bankruptcy Code (IBC).

Observations:

NCLT deliberated upon the meaning of *'Financial Debt'*[4] and *'Financial Creditors*[5]*'* as used in the IBC. As per Chapter II of the IBC, in case a corporate debtor commits a default[6], CIRP may be invoked by a financial creditor. The question which arose for consideration was whether such unpaid amount qualifies as financial debt. The prerequisite for classification of a debt as 'financial debt' is that such debt is disbursed against consideration for the time value of money, essentially meaning that inflows and outflows are distanced by time and there is a compensation for time value of money.

NCLT observed that in the impugned agreement (being a simple sale/purchase agreement of property), breach of 'assured returns' would not amount to 'financial debt'

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[4] Section 5(8) of IBC defines "financial debt" as follows:

"financial debt means a debt alongwith interest, if any, which is disbursed against the consideration ***for the time value of money and*** *includes— (a) money borrowed against the payment of interest; (b) any amount raised by acceptance under any acceptance credit facility or its de-materialised equivalent; (c) any amount raised pursuant to any note purchase facility or the issue of bonds, notes, debentures, loan stock or any similar instrument; (d) the amount of any liability in respect of any lease or hire purchase contract which is deemed as a finance or capital lease under the Indian Accounting Standards or such other accounting standards as may be prescribed; (e) receivables sold or discounted other than any receivables sold on nonrecourse basis; (f) any amount raised under any other transaction, including any forward sale or purchase agreement, having the commercial effect of a borrowing; (g) any derivative transaction entered into in connection with protection against or benefit from fluctuation in any rate or price and for calculating the value of any derivative transaction, only the market value of such transaction shall be taken into account; (h) any counter-indemnity obligation in respect of a guarantee, indemnity, bond, documentary letter of credit or any other instrument issued by a bank or financial institution; (i) the amount of any liability in respect of any of the guarantee or indemnity for any of the items referred to in sub-clauses (a) to (h) of this clause;"*

[5] Section 5(7) of IBC defines "financial creditor" as follows:

"financial creditor means any person to ***whom a financial debt is owed*** *and includes a person to whom such debt has been legally assigned or transferred to;"*

[6] Section 3(12) of IBC defines "default" as follows:

"default means non-payment of debt when whole or any part or instalment of the amount of debt has become due and payable and is not repaid by the debtor or corporate debtor, as the case may be;"

Further, Section 3(11) of IBC defines "debt" as follows:

"debt means a liability or obligation in respect of a claim which is due from any person and includes a financial debt and operational debt;"

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as there is no consideration for time value of money involved, the Applicants didn't qualify as a 'financial creditor' and hence were not eligible to initiate CIRP.

Order:

NCLT dismissed the application filed by Applicants for triggering CIRP as the Applicants didn't qualify as a 'financial creditor' under IBC, thereby failing to satisfy the criteria laid down under Section 7 of the IBC for triggering CIRP. NCLT further stated that, in any event, the petition would not have been maintainable since several winding up petitions against the Respondent were pending before the Delhi High Court and an official liquidator had already been appointed as a provisional liquidator, while the appeal was pending.

Analysis:

NCLT's observations provide clarity on the meaning and scope of 'financial debt' and 'financial creditor'. This being one of the first cases filed under IBC, it is interesting to note the analysis of these terms by the NCLT. The key takeaways from this case will serve as guidelines to be followed by financial creditors before initiating the process for corporate insolvency under the IBC, thereby clearing any ambiguity and streamlining CIRP under IBC. [*Nikhil Mehta & Sons (HUF) & Ors.* v. *AMR Infrastructures Ltd.* - Order dated January 23, 2017 in under C.P No. (ISB)-03(PB)/2017, NCLT]

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