

**NATIONAL COMPANY LAW APPELLATE TRIBUNAL, PRINCIPAL BENCH,
NEW DELHI**

Company Appeal (AT) (Ins.) No. 351 of 2020

IN THE MATTER OF:

Earth Gracia Buildcon Pvt. Ltd.

B-100, Second Floor, Naraina Industrial Area,
Phase 1, New Delhi - 110028

Through its Resolution Professional

Ms. Manisha Rawat

Having Office at A1/B, 3rd Floor, (T-2),
Sector 16, Noida-201301

...Appellant

Vs.

Earth Infrastructure Ltd.

Through its Resolution Professional

Mr. Akash Singhal,

Having Office at G-8 & 9, Hans Bhawan,
Bahadur Shah Zafar Marg,

New Delhi - 110002

...Respondent

Present:

For Appellant: Mr. Sandeep Bisht, Mr. Anuj Tiwari, Advocates.

For Respondent: Mr. Ashish Makhija, RP, Ms. Akansha Vasudeva, Advocates

J U D G M E N T

Jarat Kumar Jain: J.

The Appellant 'Earth Gracia Buildcon Pvt. Ltd.' (Financial Creditor) through its RP, Ms. Manisha Rawat has filed this Appeal against the order dated 08.01.2020 passed by Adjudicating Authority (Division Bench of the National Company Law Tribunal, Delhi, Bench – III) whereby the Adjudicating Authority rejected the Financial Creditor's application being CA/565/C-III/ND/2019 filed in CP/ 401/IB/2017 under Section 60 (5) of Insolvency and Bankruptcy Code, 2016 (hereinafter referred to as IBC).

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2. Brief facts of this case are that Earth Gracia Buildcon Pvt. Ltd. (Financial Creditor) and Earth Infrastructure Ltd. (Corporate Debtor), both these companies are undergoing Corporate Insolvency Resolution Process (CIRP). Therefore, the Financial Creditor Company is represented through the RP, Ms. Manisha Rawat whereas, the Corporate Debtor Company is represented through the RP, Mr. Akash Singhal. According to the Financial Creditor, they have advanced a sum of Rs. 16,82,17,052/- to the Corporate Debtor. The RP of Financial Creditor has filed requisite form 'C' dated 08.04.2019 before the RP of Corporate Debtor for the claim amounting to Rs. 20,78,13,695/- alongwith the ledger and bank account statement of the Financial Creditor and loan account summary of the Corporate Debtor. The RP of the Corporate Debtor on 25.07.2019 rejected the claim of the Financial Creditor for want of a loan agreement.

3. Being aggrieved, RP of the Financial Creditor filed an application under Section 60(5) of the IBC before the Adjudicating Authority. In support of the claim the Financial Creditor filed ledger, bank account statements, balance sheet for the year ending 31.03.2015 and Memorandum of Association of the Financial Creditor and loan account summary for the period 01.04.2012 to 01.03.2017 of the Corporate Debtor.

4. The RP of the Corporate Debtor has filed Reply of the application and stated that the Financial Creditor has not provided loan agreement and agreement qua payment of interest on the amount, the condition of time value for money is not satisfied. The Applicant is claiming to be a Financial Creditor only on the basis of certain entries in the books of account and bank transactions, but it is necessary that the debt should be a Financial Debt as *Company Appeal (AT) (Ins.) No. 351 of 2020*

defined under Section 5(8) of the IBC. The Financial Creditor and the Corporate Debtor are the group companies with common promoters and directors. Thus, it is prayed that the application be dismissed.

5. Ld. Adjudicating Authority after hearing Ld. Counsel for the parties held that the transactions do not fall within the purview of the definition of the Financial Debt and not supported with the consideration for the time value of money. The transactions are sham. The RP of the Corporate Debtor has rightly rejected the claim of the Financial Creditor. Resultantly, rejected the application.

6. Being aggrieved with this order, the RP of the Financial Creditor has filed this Appeal.

7. Ld. Counsel for the Appellant submits that the Financial Creditor Company was the wholly owned subsidiary of the Corporate Debtor Company till the year 2014. After 2014, the shareholding changed in the Corporate Debtor Company and pursuant to this change the shareholders became common in both the companies. Hence, as per the MoU of the Financial Creditor, the Financial Creditor has given loan from the year 2012 till 2017 to its parent company i.e. Corporate Debtor for maintaining the financial health of the parent company which is having five different projects under construction/development. Part of the loan has been repaid by the Corporate Debtor to the Financial Creditor. In support of the Financial Debt, the Financial Creditor has filed loan liability group summary of Corporate Debtor wherein the Corporate Debtor has mentioned that an amount of Rs. 12,53,40,039/- is received as loan from the Financial Creditor Company. This document was obtained from EOW Delhi Police, therefore, it is

beyond doubt. The Corporate Debtor has admitted in its Reply that the books of account demonstrate that an amount of Rs. 16,82,17,052/- is due to be paid by the Corporate Debtor to the Financial Creditor. The Ld. Adjudicating Authority ignored aforesaid clinching documents filed in support of the Financial Debt.

8. Ld. Counsel for the Appellant further submits that Ld. Adjudicating Authority ignored the ratio of the judgments passed by this Appellate Tribunal in the case of Mack Soft Tech Pvt. Ltd. Vs. Quinn Logistics India Ltd. (CA (AT) (Ins) No. 143 of 2017) and Shailesh Sangani Vs. Joel Cardoso and Anr. (CA (AT) (Ins) No. 616 of 2018) in which it was held that the disbursement of debt against consideration for the time value of money are the essential ingredients of Financial Debt but to pay interest is not only consideration, there may be other consideration also. The Appellant's application has been dismissed on the sole ground that there is no loan agreement.

9. *Per contra*, Ld. Counsel for the Respondent submits that in the transactions in question the essential requirement of 'disbursement' and 'consideration of time value of money' is absent. The Appellant has placed reliance upon the ledger account maintained by the Appellant but the Appellant failed to produce any loan agreement. Hon'ble Supreme Court in the case of Swiss Ribbons Vs. Union of India (2019) SCC Online SC 73 in para 23 held that the definition of Financial Creditor and Financial Debt makes it clear that a Financial Debt is a debt together with interest, if any, which is disbursed against the consideration for time value of money. The money that is borrowed or raised in any of the manners prescribed in Section 5(8) or otherwise, as Section 5(8) is an inclusive definition. Hon'ble Supreme Court in another matter of Anuj Jain *Company Appeal (AT) (Ins.) No. 351 of 2020*

IRP for Jaypee Infratech Ltd. Vs. Axis Bank Ltd. 2020 SCC Online SC 237 reiterated the same principle and held that the requirement of existence of debt, which is disbursed against the consideration for the time value of money, remains an essential part even in respect of any of the transactions/dealings stated in sub-clauses (a) to (i) of Section 5 (8) of the IBC even if it is not necessarily stated therein. Thus, the Appellant has failed to prove that the transaction in question is a Financial Debt. Ld. Adjudicating Authority has rightly rejected the application. Thus, the Appeal is liable to be dismissed.

10. Having heard Ld. Counsel for the parties, we have gone through the record and considered their rival submissions.

11. The only issue which arises for our consideration is whether the claim made by the Appellant is Financial Debt as defined under Section 5(8) of the IBC?

12. As per the definition given in Section 5(8) of IBC, 'financial debt' means a debt along with interest, if any, which is disbursed against the consideration for the time value of money. The essential requirement is of disbursement and consideration for time value of money. Firstly, we need to consider the nature of transactions to find out that any of the ingredient of the definition of the Financial debt is present or not.

13. The Financial Creditor and Corporate Debtor are undergoing CIRP. Therefore, they are represented through their Resolution Professionals. These RPs have no firsthand knowledge about the nature of transactions. Therefore, to know the actual nature of the transactions we have to consider the documents

which are on record. The RPs are also dependent on the documents that they have received from the erstwhile promoters/directors of the company. The RPs have no firsthand knowledge of the nature of the transactions, it reflects from the e-mail dated 23.07.2019 which was sent by the RP of the Financial Creditor to the RP of the Corporate Debtor to confirm the nature of transactions in question. Please see Annexure A9 at pg. 216 of Appeal Paper Book, the relevant portion of which is reproduced under: -

“Request you to confirm us the nature of these transactions and purpose for which this amount was taken by your company EIL. Kindly provide us necessary documents evidencing nature of these related party transactions. If you fail to provide us requisite documents, within next two days, we will be bound to move an application to NCLT for non-admission of claim.”

Disbursement of Debt.

14. It is useful to refer to the judgment of the Hon’ble Supreme Court in the case of Phoenix Arc Pvt. Ltd. Vs. Spade Financial Services Ltd. & Ors. (Civil Appeal No. 2842 of 2020) decided on 01st February, 2021 wherein it was held as under: -

“G.3.2 Financial Creditor and Financial Debt

43 Under Section 5(7) of the IBC, a person can be categorised as a financial creditor if a financial debt is owed to it. Section 5(8) of the IBC stipulates that the essential ingredient of a financial debt is disbursement against consideration for the time value of money. This Court, speaking through Justice Rohinton F Nariman, in *Swiss Ribbons Pvt. Ltd. v. Union of India*¹⁰ has held:

“42. A perusal of the definition of "financial creditor" and "financial debt" makes it clear that a financial debt is a debt together with interest, if any, which is disbursed against the consideration for time value of money. It may further be money that is borrowed or raised in any of the manners prescribed in Section 5(8) or otherwise, as Section 5(8) is an inclusive definition. On the other hand, an "operational debt" would include a claim in respect of the provision of goods or services,

including employment, or a debt in respect of payment of dues arising under any law and payable to the Government or any local authority.”

(emphasis supplied)

44 In this context, it would be relevant to discuss the meaning of the terms “disburse” and “time value of money” used in the principal clause of Section 5(8) of the IBC. This Court has interpreted the term “disbursal” in *Pioneer Urban Land and Infrastructure Ltd vs. Union of India*¹¹ in the following terms:

“70. The definition of "financial debt" in Section 5(8) then goes on to state that a "debt" must be "disbursed" against the consideration for time value of money. "Disbursement" is defined in Black's Law Dictionary (10th Edn.) to mean:

“1. The act of paying out money, commonly from a fund or in settlement of a debt or account payable. 2. The money so paid; an amount of money given for a particular purpose.”

71. In the present context, it is clear that the expression "disburse" would refer to the payment of instalments by the allottee to the real estate developer for the particular purpose of funding the real estate project in which the allottee is to be allotted a flat/apartment. The expression "disbursed" refers to money which has been paid against consideration for the "time value of money". In short, the "disbursal" must be money and must be against consideration for the "time value of money", meaning thereby, the fact that such money is now no longer with the lender, but is with the borrower, who then utilises the money....”

(emphasis supplied)

15. Hon’ble Supreme court in another matter of Anuj Jain IRP for Jaypee Infratech Ltd. (Supra) examined in detail the ingredients of Section 5(8) in para 43 of the Judgment and held that:

“43.....
The requirement of existence of a debt, which is disbursed against the consideration for the time value of money, in our view, remains an essential part even in respect of any of the transactions/dealings stated in sub-clauses (a) to (i) of Section 5(8), even if it is not necessarily stated therein. In any case, the definition, by its very frame, cannot be read so expansive, rather infinitely wide, that the root requirements of ‘disbursement’ against ‘the consideration for the time value of money’ could be forsaken in the manner that any transaction could stand alone to become a financial debt. In other words, any of the transactions stated in the said sub-clauses (a) to (i) of Section 5(8) would be falling within the ambit of

‘financial debt’ only if it carries the essential elements stated in the principal clause or at least has the features which could be traced to such essential elements in the principal clause. In yet other words, the essential element of disbursal, and that too against the consideration for time value of money, needs to be found in the genesis of any debt before it may be treated as ‘financial debt’ within the meaning of Section 5(8) of the Code. This debt may be of any nature but a part of it is always required to be carrying, or corresponding to, or at least having some traces of disbursal against consideration for the time value of money.”

16. In the light of aforesaid pronouncement of Hon’ble Supreme Court, we have examined the facts of this case. In this case, the promoters and directors of both the companies are common. Therefore, from the ledger entries of the Financial Creditor, it cannot be inferred that the money is disbursed with the lender company to the borrower company. On the other hand, the entries of ledger reflect the inflow and outflow of funds which are in the nature of running account, indicating that the debit and credit balances lack of any commercial effect of borrowing which is an essential element in terms of Section 5(8) (f) of the IBC.

Consideration for time value of money.

17. Ld. Counsel for the Appellant cited the Judgment of this Appellate Tribunal in the case of Mack Soft Tech Pvt. Ltd. (Supra) and Shailesh Sangani (Supra). In the case of Mack Soft Tech para 37 of the Judgment is as under:-

“37. Grant of loan and to get benefit of development is object of the Respondent- (‘Financial Creditor’), as apparent from their ‘Memorandum of Association’. Thus, we find that there is a ‘disbursement’ made by the Respondent- (‘Financial Creditor’) against the ‘consideration for the time value of money’. The investment was made to derive benefit of development of ‘Q-City’, which is the consideration for time value of money. Thus, we find that the Respondent- (‘Financial Creditor’) come within the meaning of

‘Financial Creditor’ and is eligible to file an application under Section 7, there being a ‘debt’ and ‘default’ on the part of the ‘Corporate Debtor’.”

18. This Appellate Tribunal in the case of Shailesh Sangani (Supra) held as under :-

“6. A plain look at the definition of 'financial debt' brings it to fore that the debt alongwith interest, if any, should have been disbursed against the consideration for the time value of money. Use of expression 'if any' as suffix to 'interest' leaves no room for doubt that the component of interest is not a sine qua non for bringing the debt within the fold of 'financial debt'. The amount disbursed as debt against the consideration for time value of money may or may not be interest bearing. What is material is that the disbursement of debt should be against consideration for the time value of money. Clauses (a) to (i) of Section 5(8) embody the nature of transactions which are included in the definition of 'financial debt'. It includes money borrowed against the payment of interest. Clause (f) of Section 5(8) specifically deals with amount raised under any other transaction having the commercial effect of a borrowing which also includes a forward sale or purchase agreement. It is manifestly clear that money advanced by a Promoter, Director or a Shareholder of the Corporate Debtor as a stakeholder to improve financial health of the Company and boost its economic prospects, would have the commercial effect of borrowing on the Company Appeal (AT) (Insolvency) No. 616 of 2018 part of Corporate Debtor notwithstanding the fact that no provision is made for interest thereon. Due to fluctuations in market and the risks to which it is exposed, a Company may at times feel the heat of resource crunch and the stakeholders like Promoter, Director or a Shareholder may, in order to protect their legitimate interests be called upon to respond to the crisis and in order to save the company they may infuse funds without claiming interest. In such situation such funds may be treated as long term borrowings. Once it is so, it cannot be said that the debt has not been disbursed against the consideration for the time value of the money. The interests of such stakeholders cannot be said to be in conflict with the interests of the Company. Enhancement of assets, increase in production and the growth in profits, share value or equity enures to the benefit of such stakeholders and that is the time value of the money constituting the consideration for disbursement of such amount raised as debt with obligation on the part of Company to discharge the same. Viewed thus, it can be said without any amount of contradiction that in such cases the amount taken by the Company is in the nature of a 'financial debt'.”

19. In the aforesaid Judgments, this Tribunal held that the disbursement of debt should be against the consideration for time value of money. However, to pay interest is not only consideration. There may be other considerations also. When the company is in dire need of funds, the promoter/director or shareholder may in order to protect the company infuse funds without claiming interest.

20. The report of the Insolvency Law Committee dated 26 March 2018 has discussed the interpretation of the term “time value of money” and stated:

“The current definition of 'financial debt' Under Section 5(8) of the Code uses the words "includes", thus the kinds of financial debts illustrated are not exhaustive. The phrase "disbursed against the consideration for the time value of money" has been the subject of interpretation only in a handful of cases under the Code. The words "time value" have been interpreted to mean compensation or the price paid for the length of time for which the money has been disbursed. This may be in the form of interest paid on the money, or factoring of a discount in the payment.”

(emphasis supplied)

21. In the present case, Financial Creditor has been unable to point out any consideration for the alleged debt. Thus, they have failed to prove that the transaction in question comes within the definition of Financial Debt.

Sham transactions.

22. Ld. Adjudicating Authority held that transactions in question are a sham. Hon'ble Supreme Court in the case of Phoenix Arc Pvt. Ltd. (Supra) held that when the transactions can be held collusive and sham.

G.3.3 Collusive Transactions

46 The above discussion shows that money advanced as debt should be in the receipt of the borrower. The borrower is obligated to return the money or its equivalent along with the consideration for a time value of money, which is the compensation or price payable for the
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period of time for which the money is lent. A transaction which is sham or collusive would only create an illusion that money has been disbursed to a borrower with the object of receiving consideration in the form of time value of money, when in fact the parties have entered into the transaction with a different or an ulterior motive. In other words, the real agreement between the parties is something other than advancing a financial debt. A useful elaboration of “sham transactions” can be found in the opinion of Diplock LJ in *Snook vs. London and West Riding Investments Ltd.*¹²:

“As regards the contention of the plaintiff that the transactions between himself, Auto Finance and the defendants were a “sham,” it is, I think, necessary to consider what, if any, legal concept is involved in the use of this popular and pejorative word. I apprehend that, if it has any meaning in law, it means acts done or documents executed by the parties to the “sham” which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create.”

(emphasis supplied)

Diplock LJ also stated:

“But one thing, I think, is clear in legal principle, morality and the authorities (see *Yorkshire Railway Wagon Co v Maclure and Stoneleigh Finance Ltd. v Phillips*), that for acts or documents to be a “sham,” with whatever legal consequences follow from this, all the parties thereto must have a common intention that the acts or documents are not to create the legal rights and obligations which they give the appearance of creating. No unexpressed intentions of a “shammer” affect the rights of a party whom he deceived...”

(emphasis supplied)

23. In the light of the proposition laid down by the Hon’ble Supreme Court, we have examined the impugned order. Ld. Adjudicating Authority in para 13 to 16 discussed the reasons for holding that the transactions in question are sham.

We can summarize these reasons as under : -

- (i) The transactions in question have no backing of the board resolution.
- (ii) There is no record to show that the Corporate Debtor was in need of use money (as Loan) involved in the transactions.

- (iii) There is no agreement of loan and interest.
- (iv) No document to stipulate the period of repayment.
- (v) The Financial Creditor Company and Corporate Debtor Company are group companies and the directors and promoters are common in both the companies.
- (vi) The balance sheet of the Financial Creditor Company for the year ending 31.03.2015 shows loan and advance of INR 18,75,76,212/- to others but the name of the Corporate Debtor Company is not mentioned.
- (vii) The essential ingredients for financial debt disbursement and consideration for the time value of money is missing.
- (viii) The Financial Creditor filed claim before the resolution professional for an amount of INR 16,82,17,052/- plus interest @ 12 % which has not been substantiated with any documentary evidence.

24. On the aforesaid grounds, Ld. Adjudicating Authority held that all these transactions are sham and involved round tripping of the huge amount.

25. We are in agreement with the reasoning of Ld. Adjudicating Authority. Hence, we uphold the findings.

26. We are of the considered view that the transactions in question between Financial Creditor and Corporate Debtor are sham in nature and do not qualify as Financial Debt, for the purposes of IBC.

27. With the aforesaid discussion, we are unable to agree with the argument advanced by the Ld. Counsel for the Appellant that RP and Ld. Adjudicating Authority rejected the Appellant's claim only for want of loan agreement. On the *Company Appeal (AT) (Ins.) No. 351 of 2020*

other hand, from the facts and circumstances it reflects that these transactions are sham. Thus, the Appellant has failed to prove that these transactions come within the definition of Financial Debt under Section 5(8) of the IBC and Appellant Company is Financial Creditor as defined under Section 5(7) of the IBC.

28. With the aforesaid discussion, we find no merit in this Appeal, therefore, the Appeal is dismissed. No costs.

[Justice Jarat Kumar Jain]
Member (Judicial)

[Kanthi Narahari]
Member (Technical)

New Delhi
08th June, 2021
SC