

National Company Law Appellate Tribunal, New Delhi
Principal Bench

Company Appeal (AT)(Ins.) No. 143 of 2021

IN THE MATTER OF:

Shree Ambica Rice Mill

A Registered Partnership Firm

Having its Registered office at:

Salajada, Dholka Road,

Bavla – 387810

Email: shreeambicariceemail@gmail.com

M. No. 9925163318

...Appellant

Vs.

M/s KaneriAgro Industries Limited

A Public Limited Company Incorporated

Under the Provisions of the Companies Act, 2013

Having its Registered Office At:

Survey No. 155/P,

Village: LodariyalBavla,

Sanand Road,

Ahmadabad – 382220

Email: kaneriagro@gmail.com

...Respondent

Present:

For Appellant:

Mr. Ketan Parikh, Advocate

For Respondent:

Mr. Jaimin Dave, Advocate for R-1

J U D G E M E N T

Jarat Kumar Jain: J.

The Appellant “Shree Ambica Rice Mill” (Financial Creditor) has filed this Appeal against the order dated 07.10.2020 passed by the Adjudicating Authority (National Company Law Tribunal, Ahmadabad Bench, Court-I).

Whereby the Financial Creditor's Application being CP (IB) No. 699/07/NCLT/AHM/2019 under Section 7 of the Insolvency and Bankruptcy Code, 2016 (IBC) has been dismissed as collusive.

2. Brief facts of this case are that Shree Ambica Rice Mill (Financial Creditor) is a partnership firm carrying on business of Paddy Milling and boiling, trading & manufacturing of rice and other agriculture produce etc. "M/s Kaneri Agro Industries Limited" (Corporate Debtor) is a company incorporated on 11.09.2018 having authorized and paid up share capital of 7 crores 30 lacs. The Corporate Debtor from time-to-time availed loan from the Financial Creditor. On 20.04.2019 the Corporate Debtor has taken a loan of Rs. 10 lacs from the Financial Creditor. That despite repeated reminders and follow ups, the Corporate Debtor miserably failed to pay the outstanding payable amount to the Financial Creditor.

3. The Financial Creditor on 19.10.2019 filed an Application under Section 7 of the IBC for initiating Corporate Insolvency Resolution Process (CIRP) against the Corporate Debtor. In support of the transaction, the Financial Creditor has filed a copy of ledger account of the Corporate Debtor for the Financial Year 2018-19 and 2019-20.

4. Ld. Adjudicating Authority issued notice to the Corporate Debtor and then the Corporate Debtor appeared through a counsel before the Adjudicating Authority and they did not controvert the claim of the Financial Creditor and also the default in repayment of the outstanding dues. Further, the Corporate Debtor through affidavit in reply dated 03.01.2020 admitted the debt of the Financial Creditor and then submitted that they have no objection, if the Adjudicating Authority admits the Application on its merits.

5. Ld. Adjudicating Authority after hearing Ld. Counsels for the parties held that:

“7. In our considered view, it is the case of collusive Application whereby the Corporate Debtor is trying to seek benefits of Moratorium under Section 14 of the IBC and other advantages in accordance with other provisions of IBC 2016 and in particular Section 31, 53 thereof by getting itself- admitted under the Corporate Insolvency Resolution Process (CIRP) and the Financial Creditors is an active partner to this exercise.

8. In this view of the matter, we dismissed this Application.

9. We also direct the Registry to issue Notice to the Financial Creditor under Section 65 of the IBC, 2016 to present their case as to why penalty may not be imposed on both the parties under this Section.”

6. Being aggrieved with this order the Financial Creditor has filed this present Appeal.

7. We have admitted the Appeal and stayed the order of issuance of show cause notice under Section 65 of the IBC as against the Appellant (Financial Creditor), during the pendency of this Appeal.

8. Ld. Counsel for the Appellant (Financial Creditor) submitted that Ld. Adjudicating Authority failed to appreciate that the amount was actually due and payable to the Financial Creditor. There is no finding that the debt in question is not a Financial Debt. Ld. Adjudicating Authority has to be satisfied mainly on two grounds that whether there is a debt and the Corporate Debtor has committed default. The moment Adjudicating Authority is satisfied that a default has occurred, the Application must be admitted unless it is incomplete. For this purpose, he cited the Judgment of Hon’ble Supreme Court in the case of M/s Innovative Industries Ltd. Vs. ICICI Bank Limited & another reported in (2018) 1 SCC 407. He also submitted that the Corporate Debtor in its Affidavit admitted that he has committed default in repayment

of debt. The Adjudicating Authority had travelled beyond the intent purpose and spirit and object of the explanation to Section 7 (1) of the IBC.

9. It is submitted that Ld. Adjudicating Authority erred in holding that Shree Ambica Rice Mill is not a Financial Creditor, as the deed of partnership to that extent is silent.

10. It is also submitted that Ld. Adjudicating Authority exceeded in its jurisdiction while investigating the nature of the transaction. Thus, the impugned order is not in the consonance with the Provisions of explanation to Section 7 (1) of the IBC.

11. Ld. counsel for the Appellant submitted that the Ld. Adjudicating Authority without any material on record drawn inference of collusive Application and directed to issue show cause notice under Section 65 of the IBC. Ld. Adjudicating Authority failed to consider that the loan was obtained by the Corporate Debtor from time to time and was also repaid as and when funds were available with the Corporate Debtor. Not only that, making payment of interest on the loan, the Corporate Debtor had deducted TDS on the said interest component. Ld. Adjudicating Authority without affording opportunity of hearing drawn inference of collusion. Such finding is perverse contrary to the evidence and material on record. The Adjudicating Authority committed a jurisdictional error. Thus, the impugned order deserves to be quashed and set aside and consequently, Application under Section 7 of the IBC to be allowed and the matter be remitted to the Adjudicating Authority for deciding the Application as per law.

12. Ld. Counsel appearing on behalf of the Respondent/Corporate Debtor submitted that the Corporate Debtor is in agreement with the arguments

advanced by the Ld. Counsel for the Appellant and the Corporate Debtor has no objection in case the impugned order is set aside.

13. After hearing Ld. Counsel for the parties, we have minutely gone through the record.

14. Following issues arose for our consideration.

(i) Whether the Adjudicating Authority has exceeded in its jurisdiction while examining the nature of transaction in question?

(ii) Whether the transaction in question is Financial Debt and the Corporate Debtor has committed default?

(iii) Whether the application in question is collusive?

Issue No. (i)

Whether the Adjudicating Authority has exceeded in its jurisdiction while examining the nature of transaction in question?

15. We would like to refer the Judgment of 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 1st February, 2021 which reads as under:

“48 The IBC has made provisions for identifying, annulling or disregarding “avoidable transactions” which distressed companies may have undertaken to hamper recovery of creditors in the event of the initiation of CIRP. Such avoidable transactions include: (i) preferential transactions under Section 43 of the IBC; (ii) undervalued transactions under Section 45(2) of the IBC; (iii) transactions defrauding creditors under Section 49 of the IBC; and (iv) extortionate transactions under Section 50 of the IBC. The IBC recognizes that for the success of an insolvency regime, the real nature of the transactions has to be unearthed in order to prevent any person from taking undue benefit of its provisions to the detriment of the rights of legitimate creditors.”

16. With the aforesaid preposition of law, it is clear that the IBC recognizes that for the success of Insolvency regime the real nature of transaction has to be unearthed in order to prevent any person from taking undue benefit of its provisions to the detriment of the rights of legitimate creditors. It means, while

admitting the Application under Section 7 of the IBC, it is the duty of the Adjudicating Authority to investigate the real nature of the transaction in order to prevent any person from taking undue benefit of its provisions to the detriment of the rights of legitimate creditors.

17. Now we would like to refer another pronouncement of Hon'ble Supreme Court in the case of *Swiss ribbons (P) Ltd v Union of India*, (2019) 4 SCC 17 held;

Para 55.
.....

"A conjoint reading of all these Rules makes it clear that at the stage of the adjudicating authority's satisfaction under Section 7(5) of the Code, the corporate debtor is served with a copy of the Application filed with the adjudicating authority and has the opportunity to file a reply before the said authority and be heard by the said authority before an order is made admitting the said Application. What is also of relevance is that in order to protect the corporate debtor from being dragged into the corporate insolvency resolution process mala fide, the Code prescribes penalties. Thus, Section 65 of the Code reads as follows:

"65. Fraudulent or malicious initiation of proceedings. — (1) If, any person initiates the insolvency resolution process or liquidation proceedings fraudulently or with malicious intent for any purpose other than for the resolution of Insolvency, or liquidation, as the case may be, the adjudicating authority may impose upon such person a penalty which shall not be less than one lakh rupees, but may extend to one crore rupees.
(2) If, any person initiates voluntary liquidation proceedings with the intent to defraud any person, the adjudicating authority may impose upon such person a penalty which shall not be less than one lakh rupees but may extend to one crore rupees."

60. Also, punishment is prescribed under Section 75 for furnishing false information in an application made by a financial creditor which further deters a financial creditor from wrongly invoking the provisions of Section 7. Section 75 reads as under:

"75. Punishment for false information furnished in Application. — Where any person furnishes information in the Application made under Section 7, which is false in material particulars, knowing it to be false or omits any material fact, knowing it to be material, such person shall be punishable with fine which shall not be less than one lakh rupees, but may extend to one crore rupees."

18. The Hon'ble Supreme Court in the above-mentioned case held that even if the Application filed under Section 7 meets all the requirements, then also

the Adjudicating Authority has exercised discretion carefully to prevent and protect the Corporate Debtor from being dragged into the Corporate Insolvency Resolution Process malafide.

19. Thus, it is clear that the Adjudicating Authority is obliged to investigate the nature of the transaction and should be very cautious in admitting the Application in order to prevent taking undue benefit of provisions of IBC to detriment of the rights of legitimate creditors as well as to protect the Corporate Debtor from being dragged into CIRP with malafide. Section 65 provides that if any person initiates the Insolvency Resolution Process or liquidation proceedings fraudulently or with malicious intent for any purpose other than for resolution of Insolvency or Liquidation, the Adjudicating Authority may impose upon such person a penalty. Section 65 provides that where any person furnishes any information under Section 7, which is false in material particulars, knowing it to be false or omits any material facts, knowing it to be material such person shall be punished with fine.

20. With the aforesaid discussion we are unable to convince with the argument of Ld. Counsel for the Appellant that Ld. Adjudicating Authority when entered into investigating the nature of the transaction then exceeded in its jurisdiction under Section 7 (5) of the IBC.

Issue No. (ii)

Whether the transaction in question is Financial Debt and the Corporate Debtor has committed default?

21. 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.

22. It is useful to refer to the judgment of the Hon'ble Supreme Court in the case of Phoenix Arc Pvt. Ltd. (Supra) it is held that:

“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 “disbursement” in *Pioneer Urban Land and Infrastructure Ltd vs. Union of India* (2019)8SCC416 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 "disbursement" 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)

23. Hon'ble Supreme court in another matter of Anuj Jain IRP for Jaypee Infratech Ltd. Vs. Axis Bank Ltd. 2020 SCC Online SC 237 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 disbursement, 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 disbursement against consideration for the time value of money."

24. In the light of aforesaid pronouncement of Hon'ble Supreme Court, we have examined the facts of this case. The Financial Creditor is not doing financial business but manufacture of rice. On the other hand, the Corporate Debtor Company incorporated on 11.09.2018 having authorized and paid share capital of 7crores 30 lacs, as per the MCA data filed by the Financial Creditor showed that the Bank of Baroda has sanctioned cash credit limit to the tune of Rs. 24 crores in the year October, 2018. According to the Financial

Creditor, they have granted a loan of Rs. 10 lacs on 20.04.2019. We are unable to convince that the Corporate Debtor Company having paid up share capital of 7 crores 30 lacs and cash credit limit to the tune of Rs. 24 Crores has to take a loan for Rs. 10 lacs from the Financial Creditor and that the Corporate Debtor is not able to make repayment of Rs. 10 lacs and has no objection if the Application under Section 7 is allowed and the CIRP initiated against the Corporate Debtor Company.

25. Apart from this significant feature of the transaction, we have considered the other circumstances which are as under:

“(a) The transaction in question has no backing of the board resolution of the Corporate Debtor Company.

(b) There is no record to show that on date of disbursement i.e., 20.04.2019 the Corporate Debtor was in need of Rs. 10 lacs (As Loan) particularly when Corporate Debtor was having cash credit limit of Rs. 24 Crores by Bank of Baroda.

(c) There is no agreement of loan and interest.

(d) No document is to stipulate the period of repayment.

(e) The essential ingredients for financial debt disbursement and consideration for the time value of money are missing. On the other hand, the entries of ledger for the financial year 2018-19, 2019-20 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. Ld. Adjudicating

Authority on the basis of Financial Statement in Para 4 of the impugned order observed that “First transaction has been squared up on the same date i.e., 16.04.2018. Next transaction is squared up in two days. 3rd transaction is squared up on the same date. Thereafter two transactions for Rs. 20 lacs and 10 lacs respectively on 26.07.2018 and 10.08.2018 against which Rs. 10 lacs have been repaid on 17.10.2018 and 20.12.2018. After sanctioned and disbursement of cash credit limit by Bank of Baroda on 12.10.2018. Thereafter a sum of Rs. 25 lacs was given on 05.02.2019 which has been repaid on 15.02.2019, 18.02.2019 and 27.02.2019. Thus, Rs. 10 lacs have remained outstanding as on 31.03.2019 in Financial Year 2019-2020. A sum of Rs. 25 lacs has been given on 17.04.2019 which has been repaid in two instalments within three days”. These facts are undisputed.

26. On the aforesaid discussion, we are of the considered view that the transaction in question is not a financial debt within the meaning of Section 5 (8) of the IBC.

27. Now, we have considered whether a default has occurred. In the Application Part- 4 serial No. 1 total amount Rs. 10 lacs disbursed on 20.04.2019 whereas in serial No. 2 the date of default is mentioned as 21.04.2019. whereas outstanding amount payable as on 30.09.2019 mentioned as 10 lacs 50 thousand. In support of date of default, the Financial Creditor has not filed any document. Therefore, it is not clear that how the financial creditor has arrived at date of default is 21.04.2019 (i.e., just next day of disbursement of loan) or 30.09.2019. It is not the case of the Financial Creditor that they have served demand notice on the Corporate Debtor and

the Corporate Debtor has failed to make the payment or the loan was given for a specific period.

28. Thus, the Financial Creditor has failed to satisfy that the transaction in question is a Financial Debt and a default has occurred.

Issue No. (iii)

Whether the application in question is collusive?

29. Ld. Adjudicating Authority held that the transaction in question is a collusive. Hon'ble Supreme Court in the case of Phoenix Arc Pvt. Ltd. (Supra) propound the test to judge 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 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)

30. In the light of the proposition laid down by the Hon’ble Supreme Court, we have examined the impugned order. As we have already discussed that the transaction in question is not a financial debt and default has not occurred. In this matter when the Adjudicating Authority sent a notice of Section 7 Application to the Corporate Debtor then Corporate Debtor appeared before Adjudicating Authority through Ld. Counsel and did not controvert the claim of the Financial Creditor and default in repayment of the debt, not only this, the Corporate Debtor filed an Affidavit before the Adjudicating Authority that they have no objection, if the Adjudicating Authority admits the Application and initiate the CIRP. Nobody will believe that the Corporate Debtor Company having paid up capital of Rs. 7 Crores 30 lacs and Bank of Baroda has sanctioned cash credit limit for the amount of Rs. 24 Crores, is not able to make a payment of Rs. 10 lacs and they have no objection, if the CIRP is initiated against the Company. In this case when the Corporate Debtor has admitted the default in repayment then they should have make the prayer that they are ready to settle the matter with Financial Creditor instead of submitting that they have no objection in admitting the application. In the

circumstances, Ld. Adjudicating Authority held that it is a case of collusive Application.

31. Now, we have considered that whether the Application is filed with other than the Resolution or for ulterior motive. Ld. Adjudicating Authority observed in the impugned order that as per the practice, MCA Data of Corporate Debtor was not filed along with the Application under Section 7 of the IBC. Hence, the matter was fixed for filing the same. Then Financial Creditor has filed MCA Data of the Corporate Debtor Company, which shown an open charge in favour of Bank of Baroda, such loan was sanctioned on 12.10.2018 and on 02.08.2019 bank declared the account of Corporate Debtor as NPA. Thereafter, the bank has initiated recovery proceedings against the Corporate Debtor under the provisions of Section 13 (4) SARFAESI Act.

32. On the basis of aforesaid material Ld. Adjudicating Authority has given a finding that the Corporate Debtor trying to seek benefits of moratorium under Section 14 of the IBC and other advantages in accordance with other provisions of the IBC and thereby rejected the Application filed under Section 7 of the IBC.

33. We are in agreement with the Ld. Adjudicating Authority as there is inevitable conclusion that the Financial Creditor colluded with the Corporate Debtor and filed the Application with other than the Resolution or for ulterior motive to prevent the Bank of Baroda to recover the debt from the Corporate Debtor.

34. With the aforesaid discussion, we are of the view that there is no merits in this Appeal. Thus, the Appeal deserves to be dismissed. The Appeal is dismissed and the interim order is vacated. However, no order as to costs.

[Justice Jarat Kumar Jain]
Member (Judicial)

[Dr. Ashok Kumar Mishra]
Member (Technical)

New Delhi

13th July, 2021

SC