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Between the lines...

A BRIEFING ON LEGAL MATTERS OF CURRENT INTEREST

KEY HIGHLIGHTS

* **NCLT:** Corporate insolvency resolution process cannot be initiated under Section 7 of IBC based on transfer agreement for purchase of debentures from financial creditors.
* **NCLAT:** Security for refund of advance amount cannot change the nature of transaction for supply of goods into financial debt.
* **Delhi High Court:** Directors of a company cannot be made a party to an arbitration proceeding which has been initiated against the company by the virtue of the 'group of companies doctrine'.
* **NCLAT:** Definition of financial debt under IBC does not use the expression that disbursement should be made to corporate debtor only.

I. NCLT: Corporate insolvency resolution process cannot be initiated under Section 7 of IBC based on transfer agreement for purchase of debentures from financial creditors.

The National Company Law Tribunal, Mumbai ("**NCLT**"), vide its judgment dated January 29, 2024, in the matter of ***Edelweiss Asset Reconstruction Company Limited v. Ajmera Realty and Infra India Limited [CP (IB) No. 877/MB/2023]***, has held that if the element of disbursal against the consideration for time value of money is absent, such transaction, cannot amount to financial debt under Section 5(8) (*Definition of 'financial debt'*) of the Insolvency and Bankruptcy Code, 2016 ("**IBC**").

Facts

On December 27, 2006, Meeti Developers Private Limited ("**MDPL**") had executed a Development Agreement ("**Development Agreement**") with New Kamal Kunj Cooperative Housing Society ("**Society**") for redevelopment of the Society's building. For the aforesaid purpose, MDPL had issued Non-Convertible Debentures ("**NCDs**") to the tune of INR 55 Crores to the predecessor of Edelweiss Asset Reconstruction Company Limited ("**Petitioner**") under a Debenture Trust Deed dated November 29, 2016 ("**Debenture Trust Deed**"). Subsequently, by virtue of a deed of assignment executed on May 21, 2019, the NCDs were assigned in favour of the Petitioner.

Thereafter, upon default in repayment of the NCDs, the Petitioner filed a company petition against MDPL under Section 7 *(Initiation of corporate insolvency resolution process by financial creditor)* of IBC ("**Company Petition**"). Subsequent to admission of MDPL in corporate insolvency resolution process ("**CIRP**"), Ajmera Realty and Infra India Limited ("**Respondent**") along with MDPL had approached the Petitioner to enter into an arrangement whereby the Respondent would purchase the NCDs from the Petitioner for a sum of INR 31,66,00,000/-. In view of the afore-mentioned, the Petitioner and the Respondent executed a Transfer Agreement dated July 8, 2022 ("**Transfer Agreement**") and Financial Undertaking dated July 8, 2022 ("**Financial Undertaking**"). The afore-mentioned agreements recorded the terms and conditions for purchase of NCDs by the Respondent and expressly stipulated that the liability of the Respondent to pay the sum of INR 31,66,00,000/- shall be absolute, unconditional and irrevocable. Further, it was stipulated that out of the sum of INR 31,66,00,000/-, the Respondent shall make an upfront payment of INR 3,26,00,000/- ("**Upfront Amount**") and the balance sum of INR 28,40,00,000/- ("**Balance Amount**") was to be paid by December 31, 2022. In case of any default in making payment in the aforesaid manner, the Respondent was liable to imposition of interest at the rate of 24% per annum. It was also agreed that the NCDs would not be transferred to the Respondent until the Respondent complies with the payment obligations under the Transfer Agreement and Financial Undertaking. Furthermore, it was agreed that upon payment of the Upfront Amount, the Petitioner shall withdraw the Company Petition.

Clause 3 of the Transfer Agreement provided for "Undertaking for Financial Obligation". Pertinently, the aforesaid clause stipulated that the Respondent agrees, undertakes, confirms and declares that it shall furnish an irrevocable and unconditional undertaking, that is, the Financial Undertaking in favour of the Petitioner and guarantees to make payment of the Balance Amount. It was further stipulated that the Petitioner shall be considered as financial creditor qua the Respondent subject to the terms and conditions as set out in the Transfer Agreement.

Accordingly, the Petitioner withdrew the Company Petition. However, despite the aforesaid withdrawal, the Respondent did not make timely payment of the Balance Amount and continued to seek extension of time for payment of the same. However, despite the Petitioner granting additional time upon acknowledgement of liability by the Respondent, the Respondent sought another extension and kept on repeatedly seeking additional time to make the balance payment. On account of the aforesaid default committed by the Respondent, the Petitioner filed the present Company Petition before NCLT. Further, the Petitioner, having a separate remedy against MDPL, filed another company petition being CP No. 624 of 2023.

Issue

Whether CIRP can be initiated under Section 7 of IBC on the basis of transfer agreement for purchase of debentures if the element of disbursal against the consideration for time value of money is absent, thereby, the debt not amounting to financial debt under Section 5(8) of IBC.

Arguments

Contentions of the Petitioner:

Petitioner submitted that the Respondent had issued a public notice dated January 14, 2023 to investigate right, title and interest of MDPL in the subject property for redevelopment. The Society had issued a reply to the aforesaid notice and alleged that MDPL had committed default of its obligations under the Development Agreement. Further, the Society had issued a notice dated February 24, 2023, thereby terminating the Development Agreement with MDPL on account of several defaults committed by MDPL. Further, the Respondent had addressed a letter dated March 14, 2023, thereby informing the Petitioner about the termination of the Development Agreement. Further, the Society and MDPL had filed cross-petition against each other under Section 9 *(Interim measures, etc., by Court)* of the Arbitration and Conciliation Act, 1996 before the High Court of Bombay. In the aforesaid proceeding, the Hon'ble High Court of Bombay passed an order dated September 12, 2023, thereby granting reliefs in favor of the Society and against MDPL. Further, by way of letter dated October 25, 2023 the Respondent terminated the Transfer Agreement and Financial Undertaking.

Petitioners submitted that under the Transfer Agreement and Financial Undertaking, the Respondent had *inter alia* given an indemnity/guarantee under the Debenture Trust Deed. Pertinently, under the afore-mentioned agreements, the Respondent had undertaken that it guarantees that it shall, upon demand, forthwith pay to the Petitioner without demur the Balance Amount, together with interest at the rate of 24% per annum (compounded annually) and further that the Petitioner shall be considered as a financial creditor of the Respondent until the aforesaid financial obligation is fully discharged to the satisfaction of the Petitioner. Further, the Respondent had also given an indemnity to the Petitioner in terms of the afore-mentioned agreements.

The Petitioner also submitted that the Transfer Agreement and Financial Undertaking are commercial contracts as mutually and bilaterally entered into between the Petitioner and Respondent. The terms of the aforesaid agreements are clear and unambiguous and the same needs to be construed strictly without altering the nature of the contract. In this regard, the Petitioner relied upon the judgment pronounced by the Hon'ble Supreme Court in the matter of ***Ramana Dayaram Shetty v. International Airport Authority of India and Others [(1979) SCC (3) 489]***, which reiterates the legal position that as a matter

of judicial interpretation, courts should interpret the language of a document on the understanding that parties intended to be bound by the interpretation of the language in its literal sense.

Further, the transaction between the Petitioner and Respondent arose pursuant to the issuance of NCDs as per the transaction between the Petitioner and MDPL. Considering the fact that the transaction between the Petitioner and MDPL falls within the scope of financial debt, an indemnity/guarantee given by the Respondent for such financial debt would also be classified as a financial debt. The Petitioner submitted that the clauses of Transfer Agreement and Financial Undertaking also specify that the liability owed by the Respondent qua the Petitioner is in the nature of financial debt.

On account of the afore-mentioned, it was contended that the transaction between the Petitioner and Respondent fulfils the test of "commercial effect of borrowing" under Section 5(8)(f) of IBC.

Contentions of the Respondent:

The Respondent contended that there has been no borrowing whatsoever by the Respondent from the Petitioner. The Respondent further submitted that there has been no disbursal of any amount by the Petitioner to the Respondent till date against consideration for time value of money. Further, it was contended that reliance on the clauses of Transfer Agreement and/or Financial Undertaking would not constitute a financial debt under Section 5(8) of IBC.

Respondent further submitted that the entire premise of the arrangement as agreed by the Respondent was that MDPL continues to have valid and subsisting development rights over the subject property in question, which in turn, would ensure that the NCDs are duly secured and assigned by the Petitioner in favour of the Respondent. However, by virtue of termination of Development Agreement on account of defaults by MDPL, the entire premise of the transaction between the Petitioner and the Respondent as contemplated under the Transfer Agreement and Financial Undertaking stood extinguished.

It was contended that the Financial Undertaking also records that the Petitioner is obligated to transfer the NCDs in favour of the Respondent along with all rights, title, interest, claims. causes of action available with the Petitioner under the debenture documents. However, the Respondent had neither taken over the liabilities of MDPL nor guaranteed the obligations of MDPL under the debenture documents. In fact, contrary thereto, Petitioner had agreed to transfer the NCDs to the Respondent along with its security interest and actionable claims against MDPL and that Petitioner had represented to the Respondent that the Petitioner has considerable value on account of the underlying security on the subject property in question, from the perspective of a valuable consideration. However, no security for payment of the aforesaid amount of balance purchase price under the Transfer Agreement has been created by the Respondent in favour of the Petitioner either under the Transfer Agreement or under the Financial Undertaking. Further, on account of the termination of the Development Agreement by the Society, MDPL neither has development rights over the subject property in question nor possession or control over the same. Therefore, the security interest created in favour of the Petitioner stands completely deteriorated and the NCDs have been rendered without any value. On account of the aforesaid reason, it was contended that the Transfer Agreement has become incapable of performance and thus stands terminated, cancelled, null and void.

Observations of the NCLT

NCLT examined the Transfer Agreement and Financial Undertaking and analyzed the nature of transaction in the present case so as to determine whether the same amounts to financial debt in terms of Section 5(8) of IBC. Basis analysis of the afore-mentioned agreements, NCLT arrived at the inference that the relation between the Petitioner and Respondent in the present transaction was that of a transferor and transferee.

In so far as the contention raised by the Petitioner that the Respondent had provided guarantee as well as indemnity to the Petitioner under the aforesaid agreements is concerned, NCLT observed that the relevant clauses of the aforesaid agreements merely provide that the Respondent was liable to pay the balance purchase price towards debentures and by merely stipulating in an agreement that the Petitioner is a financial creditor qua the Respondent shall not give the status of financial creditor to the Petitioner, unless the requirements of financial debt under Section 5(8) of the IBC are fulfilled. It was also observed that the present transaction lacks the basic criteria of disbursal against the consideration for time value of money. In this regard, NCLT relied upon the landmark judgment pronounced by the Supreme Court in the matter of ***Anuj Jain v. Axis Bank Limited [Civil Appeal Nos. 8512-8527 of 2019]*** whereby it has been observed that for a debt to qualify as a financial debt under Section 5(8) of IBC, the basic criteria to be met are that there must be a disbursal of amount against the consideration for time value of money and that the scope of interpretation of financial debt as set out under Section 5(8) of IBC cannot be stretched beyond what is provided therein. Therefore, the aforesaid criteria set out under Section 5(8) of IBC is the genesis for any debt to fall under the purview of financial debt.

Decision of the NCLT

In light of the above-mentioned observations, it was held that in the present case, the transaction was for purchase of debentures for consideration and the element of disbursal against the consideration for time value of money is absent. Therefore, NCLT held that CIRP cannot be initiated under Section 7 of IBC based on Transfer Agreement for purchase of debentures from financial creditors, when the essential criteria of disbursal against the consideration for time value of money is not getting fulfilled.

Therefore, NCLT was pleased to dismiss the present company petition.

VA View: Since the enactment of IBC, there have been multiple occasions whereby lenders have approached the Adjudicating Authority without understanding and appreciating that all kinds of debt do not fall within the criteria of financial debt under Section 5(8) of IBC, thereby leading to wastage of precious time of the Adjudicating Authority as well as of the litigants.

This judicial pronouncement is a welcome step that will set the right precedent for parties in refraining from filing cases seeking initiation of CIRP against the debtor, without ascertaining as to whether or not the nature of debt fulfils the essential criteria of disbursal against the consideration for time value of money.

In the present case, it has been clearly held that CIRP cannot be initiated under Section 7 of IBC on the basis of transfer agreement for purchase of debentures if the element of disbursal against the consideration for time value of money is absent, thereby, the debt not amounting to financial debt under Section 5(8) of IBC.

II. NCLAT: Security for refund of advance amount cannot change the nature of transaction for supply of goods into financial debt.

The National Company Law Appellate Tribunal, Principal Bench, New Delhi ("**NCLAT**"), in its judgement dated January 11, 2024, in the matter of ***Sainik Industries Private Limited v. Ritesh Raghunath Mahajan, Resolution Professional, Indian Sugar Manufacturing Company Limited [Company Appeal (AT) (Insolvency) No. 1614 of 2023]***, has held that the security of refund of the advance amount cannot change the nature of the transaction into a financial debt.

Facts

Indian Sugar Manufacturing Company Limited ("**Corporate Debtor**") was engaged in the business of manufacturing and sale of sugar. Sainik Industries Private Limited ("**Appellant**") and the Corporate Debtor entered into an agreement dated July 28, 2016, towards the supply of 5200 M.T. of white crystal sugar to the Appellant ("**Supply Agreement**"). Pursuant to the Supply Agreement, the Appellant advanced an amount of INR 10 Crores to the Corporate Debtor. As per the Supply Agreement, a penalty was to be imposed in the event Corporate Debtor failed to deliver the entire/part quantity of sugar, and contemplated giving security cheques towards refund of the advance amount paid by the Appellant.

Upon the Corporate Debtor's failure to meet its obligations under the Supply Agreement, the Appellant issued a legal notice dated January 31, 2017, calling upon the Corporate Debtor to pay applicable interest and damages. The Corporate Debtor having failed to deliver sugar as well as making payment of applicable interest prompted the Appellant to deposit the security cheques towards refund of the advance amount. However, the security cheques were dishonoured, and consequently, the Appellant initiated proceedings under Section 138 (*Dishonour of cheque for insufficiency, etc., of funds in the account*) of the Negotiable Instruments Act, 1881, against the Corporate Debtor.

The Appellant also filed a petition seeking initiation of corporate insolvency resolution process ("**CIRP**") against the Corporate Debtor under Section 9 (*Application for initiation of corporate insolvency resolution process by operational creditor*) of the Insolvency and Bankruptcy Code, 2016 ("**IBC**"). Further, the Appellant also filed a commercial suit seeking grant of money decree of an admitted amount of INR 19,55,30,723/-, after which a summary judgement was awarded on January 12, 2023 for an amount of INR 3,75,35,765/-.

CIRP was initiated against the Corporate Debtor by virtue of an application filed by Saisidha Sugar Equipments and Engineering Company Private Limited under Section 7 (*Initiation of corporate insolvency resolution process by financial creditor*) of IBC, by way of an order dated March 23, 2023 ("**CIRP Order**"), passed by the National Company Law Tribunal, Mumbai Bench ("**NCLT**"). On June 1, 2023, the Appellant submitted its claim to the interim resolution professional, classifying its debt of INR 34,65,36,490/- as a financial debt. Mr. Ritesh Raghunath Mahajan ("**Respondent**"), the resolution professional of the Corporate Debtor, rejected the claim of the Appellant and categorised the claim as an operational debt, *vide* his e-mail dated June 5, 2023.

Aggrieved by the same, the Appellant filed an interlocutory application before the NCLT to direct the Respondent to accept the Appellant's claim as a financial debt. However the same was rejected by the NCLT, *vide* its order dated October 17, 2023 ("**Impugned Order**"). Further, the Appellant's petition filed under Section 9 of IBC was also dismissed by the NCLT as infructuous since CIRP against the Corporate Debtor had already commenced by the CIRP Order.

Owing to the above, the Appellant filed an appeal before the NCLAT challenging the Impugned Order.

Issue

Whether security of refund of advance amount can change the nature of the transaction from an operational debt into a financial debt.

Arguments

Contentions of the Appellant:

The Appellant submitted that the NCLT had committed an error in appreciating the real nature of the transaction between the Appellant and the Corporate Debtor and had erroneously held that the claim of the Appellant was an operational debt, while the terms and conditions of the Supply Agreement made it clear that the claim was in fact a financial debt.

The Appellant contended that the judgement of the Hon'ble Supreme Court ("**SC**") in the case of ***Consolidated Construction Consortium Limited v. Hitro Energy Solutions Private Limited [(2022) 7 SCC 164]*** ("**Consolidated Consortium Case**"), relied upon by the NCLT, was not applicable to the facts of the present case, since the Consolidated Consortium Case only related to advance money given by the creditor as an operational debt. Further, the specific terms and conditions as laid down in the Supply Agreement were absent in the Consolidated Consortium Case.

In order to support its arguments, the Appellant relied on the judgement of the SC in the case of ***Pioneer Urban Land and Infrastructure Limited and Another v. Union of India and Others [(2019) 8 SCC 416]*** ("**Pioneer Urban Case**"), wherein the SC had laid down the test for establishing a financial debt, which in the Appellant's view, was applicable to the facts of the present case.

Contentions of the Respondent:

The Respondent contended that the transaction between the Appellant and the Corporate Debtor was a transaction for the supply of sugar and the debt arising out of such a transaction was clearly an operational debt within the definition of 'operational debt' under Section 5(21) (*Definition of 'operational debt'*) of IBC.

The Respondent submitted that the Appellant itself had filed a petition under Section 9 of IBC claiming its operational debt, which was thereafter dismissed by the NCLT as infructuous. Hence, the Appellant could not be allowed to change its stand and contend that the debt arising from the transaction was a financial debt, since the terms and conditions of the Supply Agreement clearly indicated that the nature of the transaction was that of the supply of goods and services. Besides, the provision in the Supply Agreement to give security was not uncommon even in cases of supply of goods and services. Merely because security was given to the Appellant by the Corporate Debtor, it could not lead to a conclusion that the transaction amounted to a financial debt.

Observations of the NCLAT

The NCLAT examined the definition of 'operational debt' under Section 5(21) of IBC and observed that any claim in respect of the provision of goods or services would fall within the said definition. The NCLAT observed that the Supply Agreement clearly indicated that the Appellant and the Corporate Debtor had entered into an agreement for the sale and delivery of 5200 M.T. of white crystal sugar. The NCLAT further observed that in the Consolidated Consortium Case, the SC had considered the provisions of Section 5(21) of IBC and held that the expression 'in respect of' in Section 5(21) of IBC ought to be interpreted in a broad and purposive manner in order to include all those who provided or received operational services from a corporate debtor, ultimately leading to operational debts.

In NCLAT's view, the Consolidated Consortium Case was squarely applicable to the facts of the instant case, since in that case an advance was given for carrying out the supply of goods, the project was subsequently cancelled and a claim for return of advance was laid in the said context. A similar question as to whether an advance payment was an operational debt or not arose in the said case and the SC had ruled that the advance constituted an operational debt.

The NCLAT analysed the clauses set out in the Supply Agreement and observed that the provision providing for penalty in case of failure or refusal to deliver the sugar was not uncommon in an agreement of supply and that the existence of such a clause would not mean that the Appellant's claim would constitute a 'financial debt'. Moreover, the clauses of the Supply Agreement relied upon by the Appellant in no manner reflected that the transaction between the Appellant and the Corporate Debtor was a financial transaction, and that the debt due was in the nature of a financial debt.

The NCLAT observed that the Appellant while filing an application under Section 9 of IBC claiming its operational debt indicated that the Appellant considered itself as an operational creditor. Thus, the conduct of the Appellant fully supported the stand taken by the Respondent that the Appellant's claim was an operational debt.

Decision of the NCLAT

The NCLAT found that no error had been committed by the NCLT in rejecting the interlocutory application filed by the Appellant, and that the Appellant's claim had rightly been held as an operational debt. Hence, the NCLAT dismissed the appeal filed by the Appellant.

VA View: The NCLAT has rightly observed that none of the clauses in the Supply Agreement reflected that the deal between the parties was a financial transaction and that the debt due to the Appellant was a financial debt. Besides, the Appellant filing an application under Section 9 of IBC, claiming its operational debt, indicated that the Appellant considered itself as an operational creditor and not a financial creditor.

Through this judgement, the NCLAT has emphasized that the debt arising out of a transaction for the supply of goods and services is an operational debt within the definition of 'operational debt' under Section 5(21) of IBC. The provision in an agreement providing for penalty in case of failure or refusal to deliver goods is not uncommon in an agreement of supply and that the existence of such a clause had no bearing on the nature of the transaction.

III. Delhi High Court: Directors of a company cannot be made a party to an arbitration proceeding which has been initiated against the company by the virtue of the 'group of companies doctrine'.

The Delhi High Court, *vide* its judgement dated January 24, 2024, in the matter of ***Vingro Developers Private Limited v. Nitya Shree Developers Private Limited and Others [ARB.P. 667/2023]***, has held that directors of a company cannot be made a party to an arbitration proceeding which has been initiated against the company by the virtue of the 'group of companies doctrine.'

Facts

Nitya Shree Developers Private Limited ("**Respondent**") and Vingro Developers Private Limited ("**Petitioner**") executed 12 Builder Buyer Agreements ("**Agreements**") with respect to 12 plots of land in the project for the construction of a residential township project namely "RLF City". The Agreements were signed by the director of the Respondent. The Respondent failed to deliver the possession of the plots to the Petitioner on the due date as per the Agreements, despite many reassurances from the Respondent. Accordingly, the Petitioner sent a legal notice, dated October 12, 2022, to the Respondent asking for a refund of the amount paid by the Petitioners along with the interest. However, the Petitioner was not satisfied by the reply of the Respondent and thereafter sent another notice dated December 10, 2022 but the said notice was not acknowledged by the Respondent.

Resultantly, arbitration was invoked by the Petitioner, *vide* a notice dated January 16, 2023, under Section 21 (*Commencement of arbitral proceedings*) of the Arbitration and Conciliation Act, 1996 ("**Arbitration Act**") and as stipulated in the arbitration clause of the Agreements. Since no response from the Respondent was received by the Petitioner to the notice, a petition under Section 11 (*Appointment of arbitrator*) of Arbitration Act was filed by the Petitioner for seeking appointment of an arbitrator. The Petitioner added the directors of the Respondent as parties to the arbitration proceeding along with the Respondent. The directors of the Respondent were not signatories to the agreements.

Issue

Whether the non-signatories to an arbitration agreement, that is, the directors of a company are bound by the arbitration agreement by the virtue of the 'group of companies doctrine'.

Arguments

Contentions of the Petitioner:

It was submitted by the Petitioner that the Petitioner agreed to buy a total of 12 plots of land from the Respondent in the project of the Respondent and in furtherance of the said purchase, the Petitioner made the advance payments before the execution of the Agreements as per the demand of the Respondent and the Petitioner also produced bank statements reflecting the records of payments made to the Respondent.

Further, it was submitted by the Petitioner that a total payment of INR 1,39,05,000 has been made by the Petitioner to the Respondent and the Petitioner has completely fulfilled its contractual duty and on the other hand, the Respondent has failed to do so. The Petitioner submitted that there were several

attempts made by the Petitioner to contact the Respondent and there were many false reassurances by the Respondent for the timely delivery of the plots of land and initiation of full refund after failing to deliver the possession of the plots in due time.

It was also contended by the Petitioner that the directors of the Respondent are significant parties to the petition and to substantiate its claims, the Petitioner cited the decision of the Supreme Court in the case of ***Cox and Kings Limited v. SAP India Private Limited [Arbitration Petition (Civil) No. 38 of 2020]*** ("**Cox and Kings Case**"), wherein the Supreme Court upheld the 'group of companies doctrine' and its application to bind non-signatories to an arbitration agreement and the Supreme Court also observed that under Section 2(1) (*Definition*) read with Section 7 (*Arbitration agreement*) of the Arbitration Act, 'parties' include both signatories as well as non-signatories. Additionally, it was held that there exists a difference between non-signatories and third-parties, as non-signatories are those who express consent through means other than signatures.

The Petitioners further submitted that the director of Respondent is a signatory on the Agreements executed between the parties and the statement of account of the Petitioner which is maintained with the Respondent also bears the signatures of the said director. Further, since a combined response has been filed by the Respondent and its directors, therefore the directors cannot be separated from the Respondent.

Contentions of the Respondent:

It was contended by the Respondent that the directors of the Respondent are not parties to the Agreements and therefore, the present petition is liable to be dismissed. In order to substantiate its contentions, the Respondent relied upon the judgement of ***Sundaram Finance Limited v. T. Thankam, [(2015) 14 SCC 444]***, wherein it was held that in the case of more than one party to a petition, if there are those not covered under the arbitration agreement or those not party to the arbitration agreement, then such matter cannot be referred to arbitration against such parties.

The Respondent while relying upon clause 19 of the Agreements submitted that the Petitioner only paid an amount of INR 1,39,05,000 out of a total of INR 1,54,50,000 due for the 12 plots and therefore, the Petitioner cannot expect to be given possession for the same without full payment. It was submitted by the Respondent that the Respondent has completed the project and handed over the possession to many other bona-fide purchasers who paid up the complete cost of the plots. Additionally, the Petitioner was offered the possession of the 12 plots in 2017 within the promised time period and the Respondent requested for a full payment for the said plots. However, the Petitioner failed to pay the balance sum of INR 15,45,000 which was due for payment on December 30, 2016. Further, merely a notice was received by the Respondent on October 12, 2022, to which it duly replied.

The Respondent contended that its directors have merely acted in their capacity as directors and therefore they cannot be held personally liable. The Respondent also contended that since the Agreements were only executed between the Petitioner and Respondent, there exists no arbitration agreement wherein the directors of the Respondent are parties, therefore, the name of the directors may be deleted from the array of parties before referring the matter for arbitration.

Observations of the Delhi High Court

The Delhi High Court observed that the jurisdiction of the Delhi High Court in the present case is only limited to the examination of the existence of a prima facie arbitration agreement and not to analyse the other issues in the present case. Accordingly, it was noted by the Delhi High Court that it was evident that the current dispute could be referred to arbitration as there was an arbitrable dispute between the parties arising out of the Agreements which contained an arbitration clause.

It was observed by the Delhi High Court that the Respondent was the principal and the directors of the Respondent were merely agents of the Respondent. The Delhi High Court also took into consideration the findings of the Supreme Court in the Cox and Kings Case, wherein the Apex Court emphasised on the application of the 'group of companies doctrine' and held that in order to bind a non-signatory to an arbitration agreement, there must exist a common intention between the parties to do so. In the present case, in light of the principles of the Section 182 (*"Agent" and "principal" defined*) and Section 230 (*Agent cannot personally enforce, nor be bound by, contracts on behalf of principal. Presumption of contract to contrary*) of the Indian Contract Act, 1872 ("**Contract Act**"), the Delhi High Court observed that the relationship between Respondent and its directors is that of principal and agent. In light of the above, the Delhi High Court distinguished the Cox and Kings Case from the present case, as an intention to bind a non-signatory to the agreement between the parties cannot be discerned in the present case. The Delhi Court placed reliance on the case of ***Vivek Automobiles Limited v. Indian Incorporated [(2009) 17 SCC 657]***, wherein it was held that the agent could not be sued when the principal had been disclosed.

Thus, it was observed by the Delhi High Court that it becomes clear that subject to a contract to the contrary, the agent cannot be held liable for or be bound by contracts entered into or on behalf of the principal.

Decision of the Delhi High Court

The Delhi High Court held that the directors of the Respondent are not the parties to the arbitration agreement and they are only agents by virtue of being the directors of the Respondent. Therefore in the absence of a contract to the contrary, the directors cannot be held liable for the acts done by the principal, that is, the Respondent.

VA View: The Delhi High Court analysed the current case against the backdrop of the Cox and Kings Case where the Apex Court has examined the applicability of 'group of companies doctrine'. The Delhi High Court has also emphasised on the 'separate legal entity' concept which separates the members of a company from the company. In the present case, the Court examined the applicability of 'group of companies doctrine' in the context of Indian arbitration jurisprudence and the instances where a non-signatory can be made a party to an arbitration agreement involving multiple parties.

This case has emphasised the scope, extent, and limitation on the obligations of a director of a company by virtue of his position as a 'director'. As per the Delhi High Court, there exists a relationship of principal-agent between a company and its directors, as envisaged in the Contract Act. Therefore, it was rightly held that under the 'group of companies doctrine' the directors of a company cannot be made a party to an arbitration agreement since the directors of a company are merely agents to the principal, that is, the company.

IV. NCLAT: Definition of financial debt under IBC does not use the expression that disbursement should be made to corporate debtor only.

The National Company Law Appellate Tribunal ("**NCLAT**"), *vide* its order dated January 2, 2024, in the matter of ***Rajeev Kumar Jain v. Uno Minda Limited [2024 SCC OnLine NCLAT 28]***, has held that the definition of financial debt does not use the expression that disbursement should be made to the corporate debtor only. It further observed that the disbursement made on behalf, or at the instructions, of the corporate debtor will tantamount to disbursal made to the corporate debtor.

Facts

M/s. Unicast Autotech Private Limited ("**Corporate Debtor**") was engaged in the business of manufacturing aluminium die casts and M/s. Uno Minda Limited ("**Respondent**") was engaged in the business of supplying automotive solutions to original equipment manufacturers. Mr. Rajeev Kumar Jain ("**Appellant**") was an ex-director and one of the shareholders of the Corporate Debtor.

The Corporate Debtor and its promoters including the Appellant approached the Respondent to discuss sale of 100% stake in the Corporate Debtor to the Respondent. The Appellant and other promoters of the Corporate Debtor agreed to transfer the Corporate Debtor along with its asset for INR 3 Crores against its outstanding dues through a Non-Binding Offer made by the Respondent ("**NBO**").

In furtherance of the NBO, the Corporate Debtor and its promoters entered into a Business Support Agreement ("**BSA**") with the Respondent. The BSA provided that the Respondent will acquire 100% shareholding of the Corporate Debtor and further agreed to supply raw material funding and critical capital working requirements and it was decided that all such money lent would be considered as unsecured debts given by the Respondent to the Corporate Debtor.

In May 2021, the Corporate Debtor approached the Respondent for further financial assistance. During discussions, the Respondent asked the promoters to pledge their entire shareholding in the Corporate Debtor and also furnish respective guarantees and accordingly the promoters along with its sister concern, M/s. Kiran Udyog Private Limited (collectively referred to as "**Promoter Group**") pledged their shares, *vide* a Share Pledge Agreement dated May 12, 2021 ("**SPA**"), and issued the deed of guarantee.

The Respondent continued to provide support to the Corporate Debtor in acquiring goods required for its operations and between April, 2021 to May, 2021 certain payments were made by the Respondent amounting to INR 1.15 Crores. However, due to financial distress of the Corporate Debtor, the same could not be repaid to the Respondent.

Respondent issued a notice terminating the BSA and called upon the Promoter Group to repay INR 1.43 Crores as outstanding amount along with interest as per the BSA. The Appellant did not reply to the said notice. However, the Corporate Debtor repaid INR 24 Lakhs to the Respondent. The Respondent issued a legal notice for invoking guarantee furnished by the Promoter Group and calling them to pay outstanding dues and ultimately filed an application under Section 7 (*Initiation of corporate insolvency resolution process by financial creditor*) of the Insolvency and Bankruptcy Code, 2016 ("**IBC**") which was admitted by the National Company Law Tribunal, New Delhi ("**NCLT**"), *vide* its order dated July 8, 2022 ("**Impugned Order**").

Being aggrieved by the Impugned Order, the Appellant filed an appeal before the NCLAT.

Issue

Whether the debt given by the Respondent to the Corporate Debtor was a financial debt or an operational debt.

Arguments

Contentions of the Appellant:

The Appellant argued that the Impugned Order is illegal as there was no financial debt against the Corporate Debtor and the money owed to the Respondent could not have been treated as financial debt as no financial assistance has been provided by the Respondent and there was no time value of money involved.

The Appellant stated that the NCLT erred in concluding that the debt was a financial debt because it is secured by SPA and deed of guarantee, whereas the Corporate Debtor never agreed to repay the debt to the Respondent. The Appellant submitted that the understanding between the parties was that such unsecured debts would become payable only from the promoters.

The Appellant argued that except the BSA, the Respondent was also in charge of the Corporate Debtor, both in respect to company affairs and financial affairs and the Respondent cannot assume the character of a financial creditor.

Contentions of the Respondent:

The Respondent argued that the default was committed in making repayment to the Respondent and referred to several clauses of the BSA and SPA in support of its arguments that there was clear financial debt and not operational debt. The Respondent argued that the debt and the liability of the borrowers was an admitted position between the parties and once default takes place, it is the right of the financial creditors to approach NCLT. The Respondent contended that BSA was entered into by both the Corporate Debtor and its promoters and only the Corporate Debtor had been repaying the amount so far to the Respondent.

The Respondent highlighted that the BSA stated that both the Corporate Debtor as well as its promoters were to make the payments and also defined the joint and several liability on both the Corporate Debtor as well as its promoters.

Respondent denied that it was looking after the management of the Corporate Debtor and submitted that clause 3.2 of BSA was incorporated only to protect the financial interest of the Respondent, which provided that any withdrawal and borrowing of money or operation of the bank account of the Corporate Debtor was required to be approved by two persons, one from the Corporate Debtor and one from the Respondent.

Observations of the NCLAT

The NCLAT observed that financial debt means debt along with interest, if any. This means that interest is not *sine qua non*, therefore, interest may or may not be payable by the Corporate Debtor and it is the understanding between the parties which is significant and relevant to ascertain the existence of time value of money which can be in several forms, other than pure payment of interest.

The NCLAT observed that the definition of financial debt under Section 5(8) (*Definition of 'financial debt'*) of IBC does not use the expression that disbursal should be made to a corporate debtor only. Hence, it can be implied that any disbursal made on behalf of the Corporate Debtor or at the instructions of the Corporate Debtor may also tantamount to disbursal made to the Corporate Debtor. The NCLAT also observed that the Corporate Debtor was the beneficiary of such disbursal made by the Respondent.

The NCLAT observed that the BSA, SPA and deed of guarantees were made jointly by the Corporate Debtor, its promoters and the Respondent. The Corporate Debtor procured raw material from vendors for which payments were made by the Respondent, at the instructions of the Corporate Debtor and therefore it assumes the character of financial debt. The NCLAT also observed that the Respondent was only supplying funds for working capital needs of the Corporate Debtor which is nothing but financial debt. The NCLAT observed that any financial assistance towards working capital cannot be treated as operational debt and has to be taken only as financial debt.

Decision of the NCLAT

In view of the above, the NCLAT held that there was a financial debt and default which was rightly appreciated by NCLT in the Impugned Order and accordingly the appeal was dismissed by NCLAT.

VA View: The NCLAT has rightly observed that while 'financial debt' under IBC means a debt along with interest, if any, however the element of interest is not absolutely necessary and it is the understanding between the parties which is significant and relevant to ascertain the existence of time value of money which can be in several forms, other than pure payment of interest.

Further, NCLAT has correctly noted that the definition of financial debt under IBC does not use the expression that disbursement shall only be made to a corporate debtor. Therefore, NCLAT was correct in arriving at the conclusion that disbursement made on behalf, or at the instructions, of a corporate debtor will tantamount to disbursement made to a corporate debtor. Since the corporate debtor is the beneficiary in these scenarios, the disbursed amount shall assume the character of financial debt.

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