LIMITING THE LIMITATION: THE CURIOUS CASE OF LIMITATION ACT AND IBC

I. INTRODUCTION

The law regime pertaining to insolvency in India has developed over time, resulting in consolidation of laws regarding rehabilitation of the corporate entities and their liquidation.

One such consolidation came in the form of the Insolvency and Bankruptcy Code, 2016 ("**IBC**" or "**Code**"). However, IBC too, like all other legislations, came with its share of problems, ambiguities, loopholes, and inconsistencies, which were remedied either by judicial intervention and/or by subsequent amendments by the Legislature.

From the applicability of Section 14 moratorium on personal guarantors and the retrospective applicability of Section 14(3)(b) of IBC[1] to failure to take into account the period post initiation of Corporate Insolvency Resolution Process ("**CIRP**") and prior to formation of Committee of Creditors while introducing Section 12A pertaining to withdrawal of Petition[2]; much has been interpreted, reviewed and decided by the Judiciary ever since the inception of the IBC.

Apart from giving effect to the true spirit of IBC, the Courts in India have dealt with and decided a very important and key issue of applicability of Limitation Act, 1963 on the proceedings and applications under IBC[3].

More recently, the National Company Law Appellate Tribunal ("**NCLAT**") in its judgments in *Ishrat Ali Vs. Cosmos Cooperative Bank Ltd. & Anr.*[4] and *V. Padmakumar Vs. Stressed Assets Stabilisation Fund (SASF) & Anr.*[5] had the occasion to analyse and decide the issue of acknowledgement of a debt (debt as defined in the IBC for the purpose filing an application under Section 7 of the IBC) in the books of accounts and initiation of a fresh period of limitation in terms of Section 18 of the Limitation Act.

In the present Article, we have analysed the key developments surrounding the jurisprudence pertaining to the applicability of Limitation Act to the IBC and have also examined the holding of NCLAT in the cases of *Ishrat Ali* (*supra*) and *V. Padmakumar* (*supra*).

II. APPLICABILITY OF LIMITATION ACT ON PROCEEDINGS UNDER IBC

[1] *State Bank of India v. V. Ramakrishnan & Anr.*AIR 2018 SC 3876
[2] *Swiss Ribbons Private Limited & Ors. v. Union of India and Ors.,* (2019) 4 SCC 17
[3] *B. K. Educational Services Private Limited v. Parag Gupta and Associates*, (2019) 11 SCC 633
[4] Company Appeal (AT) (Insolvency) No. 1121 of 2019
[5] Company Appeal (AT) (Insolvency) No. 57 of 2020

One step back, two steps forward. The legislative and judicial development regarding the applicability of the Limitation Act, 1963 to the IBC is much the same. The IBC did not contain any provision dealing with the issue of limitation for filing petitions under Section 7 and 9, when it was first enacted. Neither was there any provision in this regard nor was the Limitation Act, 1963 made applicable to IBC.

It was the NCLT, Delhi which, for the first time, took a view that the provisions of Limitation Act shall be applicable to the proceedings under IBC.[6] However, the NCLAT, in an appeal on the same question of law, held that so long as there is a debt, including interest, and there is default of debt having continuous course of action, it cannot be said that the claim will be barred by Limitation[7]. The NCLAT held that IBC being a complete Code has purposely ignored the applicability of the Limitation Act[8]. This decision of NCLAT opened floodgates for several petitions which arose out of time barred debt.

This conflict regarding the applicability of the Limitation Act to the IBC finally came up for consideration before the Hon'ble Supreme Court in the matter of *B.K. Educational Services Private Limited v. Parag Gupta and Associates*[9]. In the meantime, the legislature amended the IBC and inserted Section 238A which made the provisions of the Limitation Act, 1963 applicable to proceedings before NCLT and NCLAT. This amendment was deemed to have come into force on June 6, 2018.

In view of the newly inserted Section 238, the Supreme Court of India was faced with a two-fold question in the matter of *B.K. Educational Services Private Limited* (*supra*). First, whether the provisions of the Limitation Act would apply to proceedings initiated under Section 7 and/ or 9 since the commencement of the Code., i.e., December 01, 2016 and secondly, whether the Limitation Act is triggered on the commencement of IBC or on the date of default.

The Supreme Court, while dealing with the first issue, held that Section 433 of Companies Act, dealing with applicability of Limitation Act to proceedings before NCLT and NCLAT, will be applicable to Tribunals while deciding proceedings under Section 7 and 9 of the IBC. It also ruled that Section 238A shall be retrospective, thereby eliminating the burden of entertaining applications seeking to revive the otherwise dead claims. Therefore, answering the first issue in affirmative, it was held that the Limitation Act will apply to proceedings initiated under Section 7 and/ or 9 since commencement of the Code., i.e., December 01, 2016. As regards the second issue, the Supreme Court analysed the terms "debt due", "default" and "due and payable" and held that the Limitation Act gets triggered from the date of default and that the date of enforcement of the IBC is wholly irrelevant for triggering the limitation period.[10]

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[6] Refer to *M/s Deem Roll -Tech Limited vs. R.L. Steel & Energy Ltd.*, Company Application No. (I.B.)24/PB/2017, and *Sanjay Bagrodia vs. Satyam Green Power Pvt. Ltd*., Company Petition No. (I.B.)108(PB)/2017

[7] *Neelkanth Township and Construction Pvt. Ltd. vs. Urban Infrastructure Trustees Limited* [2017] 143 SCL 538

[8] *Speculum Plast Pvt. Ltd. and Ors. vs. PTC Techno Pvt. Ltd. and Ors.* [2018] 142 CLA 165

[9] *Supra* note 3

[10] *See also Sagar Sharma and Ors. v. Phoenix ARC Pvt. Ltd. and Ors.* [2019] 156 SCL 707 (SC)

III. SCOPE AND EXTENT OF APPLICABILITY OF SECTION 18 ON IBC PROCEEDINGS

The Amendment of the IBC in 2018[11] and the judgement passed in the matter of *B.K. Educational Services Private Limited* (*supra*) have cleared the uncertainty regarding applicability of Limitation Act on the IBC proceedings.

Therefore, it is now certain that: (i) Limitation Act is applicable to applications filed under Sections 7 and 9 of the IBC from the inception of the Code and that the limitation period for such applications is governed by Article 137 of the Limitation Act; (ii) "The right to sue" under Section 7 and 9 accrues when a default occurs; (iii) If the default has occurred over three years prior to the date of filing of the application, the application would be barred under Article 137 of the Limitation Act.[12]

Before proceeding further with the discussions, it is necessary to analyze the purpose and rationale of Section 18 of the Limitation Act and the applications permissible under Section 7 and Section 9 of the IBC.

According to Section 18 of the Limitation Act, an acknowledgement of liability, made in writing in respect of any right claimed by the opposite party and signed by the party against whom such right is claimed, made before the expiration of the prescribed period for a suit in respect of such right, has the effect of commencing a fresh period of limitation from the date on which the acknowledgement was so signed.[13] The acknowledgment, if any, has to be prior to the expiry of the prescribed period for filing the suit. In other words, if the limitation has already expired, it would not revive under this section.[14]

Further, Section 7 of the IBC prescribes that a Financial Creditor[15], may file an application for initiation of CIRP against a Corporate Debtor[16] when 'a default has occurred'. The same expression is used when it comes to an operational creditor, who may, on the occurrence of a default under Section 8, deliver a demand notice.[17] The period of limitation, therefore, starts to run from the date of occurrence of default.

In light of the above and on conjoint reading of Section 7 and 9 of the IBC and the Section 18 of the Limitation Act, it is quite obvious that an acknowledgement of liability by the Corporate Debtors, in writing, made before the expiry of the prescribed period of three years from the date of default for the purpose of filing an application under IBC, has the effect of commencing a fresh period of limitation from the date on which the acknowledgement was so signed. In this context, the judgements in the matters of *V. Padmakumar* (*supra*) and *Ishrat Ali* (*supra*) deal with this aspect of 'acknowledgement of liability made in writing' by way of an acknowledgement of debt in the books of accounts or balance sheet by the Corporate Debtor.

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[11] Insolvency & Bankruptcy Code (Amendment) Ordinance, 2018
[12] *Supra* note 3
[13] *Food Corporation of India v. Assam State Cooperative Marketing & Consumer Federation Ltd.*, (2004) 12 SCC 360
[14] *Sampuran Singh v. Niranjan Kaur*, (1999) 2 SCC 679
[15] "financial creditor" means any person to whom a financial debt is owed and includes a person to whom such debt has been legally assigned or transferred to.
[16] "corporate debtor" means a corporate person who owes a debt to any person.
[17] *Supra* note 3.

1. ***Whether a decree passed by a Court for recovery of money can forward/ shift the date of default to the date of dishonour of decree for purpose of computing limitation period for filing an application under Section 7 of the Code.***

In *Ishrat Ali* (*supra*), the account of the Corporate Debtor was classified as NPA as on March 30, 2014. Consequently, on December 6, 2014, the bank issued a demand notice under Section 13(2) of SARFAESI Act and on January 16, 2017 the bank secured possession of movable assets under Section 13(4) of the SARFAESI Act. The bank had also initiated arbitration against the Corporate Debtor as on January 16, 2017. The Adjudicating Authority admitted the petition under Section 7 of the IBC initiating CIRP for the Corporate Debtor. The ex-director/ shareholder of the Corporate Debtor challenged the order passed by the Adjudicating Authority on the ground that it is barred by limitation.

The NCLAT, relying on precedents, held that mere filing of a suit (or initiating arbitration) for recovery or a decree passed by a Court cannot defer the date of default.

The NCLAT relied on the judgment of the Supreme Court in *Jignesh Shah and Ors. vs. Union of India (UOI) and Ors.*[18] where it was held that a suit for recovery filed for a cause of action which is within limitation cannot, in any manner, impact the separate and independent remedy of a winding up proceeding. In law, when time begins to run, it can only be extended in the manner provided in the Limitation Act. For example, an acknowledgement of liability under Section 18 of the Limitation Act would certainly extend the limitation period, but a suit for recovery, which is a separate and independent proceeding distinct from the remedy of winding up would, in no manner, impact the limitation period within which the winding up proceeding is to be filed, by somehow keeping the debt alive for the purpose of the winding up proceeding.

Alternatively, based on another judgment of NCLAT in the matter of *Sesh Nath Singh & Ors. v. Baidyabati Sheoraphuli Cooperative Bank Ltd.*[19], it was argued by the Corporate Debtor in *Ishrat Ali (supra)* that the time spent while prosecuting a suit (or arbitration proceedings) for recovery must be excluded for the purpose of computing the period of limitation as per Section 14 of the Limitation Act. Section 14 of the Limitation Act prescribes 'exclusion of time of a *bona fide* civil proceeding (of first instance or appeal or revision) in court without jurisdiction against the same party and for the same relief'. However, this judgement was not considered by the NCLAT and the NCLAT ultimately came to a conclusion that the judgment of *Sesh Nath Singh (supra)* would not come to the aid to the Corporate Debtor.

The NCLAT held that, taking an action under Section 13 of SARFAESI Act, 2002, cannot be termed to be a civil proceeding before a Court of first instance or appeal or revision before an Appellate Court and the other forum and therefore, cannot be excluded as per the Section 14 of Limitation Act. Likewise, proceedings under IBC cannot be equated with recovery suit and the prayers sought in IBC proceedings *vis-à-vis* a recovery suit are materially different. Therefore, no advantage can be reaped out of Limitation Act.

[18] (2019) 10 SCC 750
[19] Company Appeal (AT) (Insolvency) No. 672 of 2019

Therefore, on an analysis of the judgement in *Ishrat Ali (supra)*, it can be said that while a decree holder, who is a creditor as stipulated under Section 3(10) of the IBC, is eligible to file a claim before the resolution professional or the liquidator, as the case may be, such a decree holder shall not be entitled to the benefit of commencement of a fresh period of limitation upon passing of a decree nor can he seek exclusion of time basis Section 14 of Limitation Act. Consequently, for filing proceedings under Section 7 or 9 of the Code, the three years limitation period begins to run from the date of occurrence of default in payment of the debt and is not extended/ shifted upon initiating a civil proceeding or upon passing of any decree.

2. ***Whether provisioning of future obligations in financial statements (pursuant to a decree) have an effect of initiating fresh limitation period as contemplated in Section 18 of the Limitation Act.***

The issue came up for consideration before a Five-Judge Bench of NCLAT in *V. Padamakumar* (*supra*), where the Tribunal was faced with a situation where, upon failure to repay the financial facility, the corporate debtor was classified as NPA in the year 2002. Thereafter, a decree was passed in August 2009 in an Original Application filed by the bank. This decree reflected in the Balance Sheet of the Corporate Debtor, as on March 31, 2012. It was argued by the bank that acknowledgment of a debt in the financial statement after passing of a decree is enough to trigger Section 18 of the Limitation Act and initiate fresh period of limitation.

The NCLAT, while relying on one of its other judgement in the matter of *Sh. G Eswara Rao v. Stressed Assets Stabilisation Fund*[20] held that acknowledgment in the Balance Sheet or Annual Returns cannot be treated as an acknowledgment of debt under Section 18 of the Limitation Act. The NCLAT reasoned that accepting such an argument may amount to indefinite extension of limitation period since preparation and filing of balance sheet/ annual return, every year, is mandatory under law.

The minority judgement in *V. Padmakumar* (supra) and *Ishrat Ali* (*supra*) disagreed with the finding by the majority judgement. The minority judgement reasoned that merely because preparation and filing of financial statements is mandated under the Companies Act and that its failure may have penal consequences, it cannot be said that the same cannot be treated as an acknowledgement of debt under Section 18 of the Limitation Act. Based on the discussion in various prior judgements, the minority judgement concluded that financial statements must be read as whole (along with notes and directors report) to investigate if the financial statements actually amount to admission for the benefit of Section 18 of the Limitation Act.

It is worthwhile to note that Section 129 of the Companies Act, 2013 ("**CA**") require that the company must, in compliance with the Accounting Standards ("**AS**") and in compliance with Schedule III of the Companies Act, 2013, disclose true and fair state of affairs of the financial status of the company. The Schedule III of the CA also requires financial statements to include notes to account, in addition to, the other requirements as per the AS and Schedule III, thereby, enabling company to dispute the liability reported in its financial statements.

[20] Company Appeal (AT) (Insolvency) No. 1097

The minority judgement relied on the judgement of the Calcutta High Court in *Re. Padam Tea Co. Ltd.*[21] to hold that the entity may, in its notes to financial statements or directors' report, refuse to acknowledge the liability to a creditor. In such situation, it is important to find out the total effect of the document, as a whole, for purpose of ascertaining admission for the benefit of Section 18 of the Limitation Act.

IV. CHALLENGE BEFORE THE SUPREME COURT: *COSMOS CO-OPERATIVE BANK LIMITED V. ISHRAT ALI AND ANR.*[22]

Presently, the judgement passed by the NCLAT in *Ishrat Ali* (*supra*) is sub-judice before the Supreme Court.

Though, the issue is still sub-judice and yet to attain the final stamp of decision, it will be interesting to see how the Supreme Court of India perceives this dichotomy. The collaboration between the Limitation Act and the IBC is still an uphill battle, to say the least.

INDUSLAW VIEW

The jurisprudence regarding applicability of the Limitation Act to the proceedings under IBC has had its ebbs and flows. In the absence of a direct provision and in view of the conflicting opinions in the judicial interpretations, it is still a long way till the jurisprudence on the interplay of Limitation Act and IBC is established. In the intervening period, courts have been exposed to several complications like backdoor entry, enforcement of stale or dead claims etc.

Introduction of Section 238A to the IBC and the judgment by the Supreme Court in *B.K. Educational Services Private Limited* (*supra*) has, undoubtedly, laid the foundation for establishing the jurisprudence on the issue. A possible first step to these interpretations, as enumerated hereinabove, more specifically on the interplay of Section 18 of the Limitation Act and IBC has set the discussion in motion, albeit, leaving much to be answered.

In our view, the decision arrived at by the majority in case of *Ishrat Ali* case (*supra*) and *V. Padmakumar* case (*supra*) may give rise to certain ambiguities and close the doors for some genuine claims and debt. To say that, merely because preparation and filing of financial statements, in a fixed form and shape, is mandatory and therefore, cannot be read as an acknowledgment of debt for the purpose of Section 18 of Limitation Act may be unfair in some cases and each such case ought to be decided on the facts and circumstances of the case. It is beyond doubt that the preparation and filing of financial statements, in a prescribed form and manner are mandatory and failure to abide by it would entail serious penal consequences. However, it may not be out of place to investigate the facts of each case so that the debtors do not take advantage of the situation, instead of dismissing the plea altogether. The Appellate Tribunal, through its majority judgement, did not consider that the corporate entities have the flexibility of acknowledging its liability in the Balance Sheet, with protest or demur, either through its directors' report or notes

[21] AIR 1974 Calcutta 170
[22] Civil Appeal No. 2209 of 2020.

of financial statements or otherwise. It is also settled law that for purpose of ascertaining admission/ acknowledgement it is necessary that the financial statements are read as whole, that is, along with the directors' report or notes to the financial statements. So long as the acknowledgment of claim made in the financial statements is without any demur or protest, the same ought to be sufficient to initiate fresh period of limitation as stipulated under Section 18 of the Limitation.

In our view, an absolute bar to consider the acknowledgement of debt in financial statements for the benefit of Section 18 of the Limitation Act has curtailed the scope of enquiry or investigation into such acknowledgement, which ideally, would be best dealt with on a case to case basis.

In view of the appeal pending before the Supreme Court, it would be interesting to see how the Supreme Court balances the concerns of the majority and minority judgements in one breath.

It is beyond doubt that the jurisprudence on the association between Limitation Act and IBC is set to evolve in the times to come and we may witness varied interpretations and understandings, which we will keep updating in the future.

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