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NCLAT: Acknowledgement of debt cannot revive the defaults that occurred during the pre-Section 10A period under the Insolvency and Bankruptcy Code, 2016, particularly when the acknowledged debt is partially paid

The National Company Law Appellate Tribunal, Chennai (“NCLAT”) in *Sudhir Bobba (Suspended Director of Servomax Limited) vs. M/s. TVN Enterprises*¹, has held that defaults occurring during the pre-Section 10A period under the Insolvency and Bankruptcy Code, 2016 (“IBC”), do not continue to constitute a ‘default’ thereafter once the corporate debtor has made partial payments toward the (acknowledged) debt accumulated during the period excluded under Section 10A of IBC².

Brief facts

1. M/s. Servomax Limited (“**Corporate Debtor**”), placed several purchase orders with M/s. TVN Enterprises, (“**Operational Creditor**”), for the supply of goods until September 15, 2020. The Operational Creditor fulfilled these purchase orders and raised corresponding invoices. While the Corporate Debtor made periodic payments against the invoices, an outstanding amount of INR 1,00,49,270 (Indian Rupees one crore forty-nine thousand two hundred and seventy) remained unpaid.
2. On September 29, 2022, the Operational Creditor recorded the outstanding debt of INR 1,00,49,270 (Indian Rupees one crore forty-nine thousand two hundred and seventy) with the National E-Governance Services Limited (“**NeSL**”). Subsequently, on September 28, 2022, the Operational Creditor issued a demand notice to the Corporate Debtor under Section 8 of the IBC. Upon the Corporate Debtor's failure to discharge the liability or raise a valid dispute, the Operational Creditor filed an application under Section 9 of the IBC before the National Company Law Tribunal, Hyderabad (“**NCLT**”), seeking initiation of the Corporate Insolvency Resolution Process (“**CIRP**”) against the Corporate Debtor.
3. By an order dated February 22, 2024, the NCLT admitted the Section 9 application and initiated CIRP against the Corporate Debtor, based on the following observations:
 - a) As of November 11, 2022 (the filing date), the operational debt of ₹1,00,49,270 (Indian Rupees one crore forty-nine thousand two hundred and seventy) exceeded the statutory threshold of INR 1,00,00,000 (Indian

¹ Company Appeal (AT) (CH) (Ins.) No.95 of 2024, NCLAT, Chennai

² Section 10A of the IBC provides a temporary suspension of the initiation of CIRP for defaults arising on or after March 25, 2020, and until a specified period, due to the COVID-19 pandemic. It prevents insolvency proceedings against defaulting companies during this period to protect them from being dragged into insolvency due to the pandemic's economic impact.

Rupees one crore) under Section 4 of the IBC and the Corporate Debtor failed to establish any pre-existing dispute regarding the debt.

- b) Although certain invoices fell within the exclusion period under Section 10A of the IBC (March 25, 2020 – March 25, 2021), the NCLT held that Section 10A of the IBC did not apply because:
 - i) The default first occurred on March 14, 2020 (date of default mentioned in the NeSL) which is prior to the Section 10A exclusion period.
 - ii) The default continued throughout and beyond the Section 10A exclusion period.
 - iii) The Corporate Debtor acknowledged the outstanding debt after March 25, 2021, through financial statements for FY 2021-2022. The Corporate Debtor also issued a debt confirmation letter dated January 5, 2022, as well as 3 (three) post-dated cheques totaling INR 39,94,000 (Indian Rupees thirty-nine lakh ninety-four thousand), which were subsequently dishonored.
- c) Aggrieved by the NCLT's order, Mr. Sudhir Bobba, the suspended director of the Corporate debtor, filed an Appeal before the NCLAT.

Issue

Whether the CIRP can be initiated on the basis of the default of invoices between March 25, 2020, and March 25, 2021 (during the Section 10A exclusion period under the IBC) only because the Corporate Debtor acknowledged the debt post-March 25, 2021?

Findings and analysis

The NCLAT allowed the appeal and set aside the NCLT's order admitting the Corporate Debtor into CIRP. The NCLAT decided on the above issue in the following manner:

1. **Applicability of Section 10A:** The NCLAT emphasised that under Section 10A of the IBC, no CIRP application can be filed for defaults arising between March 25, 2020, and March 25, 2021.
2. **Effect of Acknowledgement of Debt:** Despite the Corporate Debtor acknowledging the debt post-March 25, 2021, the NCLAT held that such acknowledgment could not revive defaults occurring during the Section 10A period or circumvent the statutory bar.
3. **Debt Calculation:** Defaults arising out of invoices before the exclusion period are not covered by Section 10A of the IBC. However, in the present case, out of the total claimed debt of INR 1,00,49,270 (Indian Rupees one crore forty-nine thousand two hundred and seventy), INR 97,62,508 (Indian Rupees ninety-seven lakh sixty-two thousand five hundred and eight) related to 27 (twenty-seven) invoices that fell due during the Section 10A period. Excluding these, only an amount of INR 2,86,762 arises out of an invoice dated February 13, 2020, remained. However, the remaining amount did not meet the INR 1,00,00,000 (Indian Rupees one crore) threshold under Section 4 of the IBC.
4. **Distinction from Precedents:** The NCLAT distinguished the present case from other judgments by emphasising that each unpaid invoice constitutes a separate default, and that the debt accrued during the Section 10A period cannot be included in CIRP initiation.
5. **Legal Remedies:** The NCLAT clarified, citing the Supreme Court's ruling in *Ramesh Kymal vs. Siemens Gamesa*³, that the debt itself is not extinguished, and the Operational Creditor may seek its remedies for recovery through other legal avenues - outside the IBC framework.

³ (2021) 3 SCC 224

Conclusion

The NCLAT's ruling provides clarity on the interplay between Section 10A of IBC and the acknowledgment of debts incurred during the pandemic's exclusion period. The NCLT's decision underscores that defaults occurring within the Section 10A exclusion window cannot be revived for the purpose of initiating CIRP through subsequent acknowledgments made post-exclusion period.

For creditors, this decision highlights the importance of understanding the temporal boundaries set by Section 10A of the IBC. Acknowledging debts that accrued during the exclusion period does not extend the window for initiating CIRP beyond the statutory limits. Consequently, creditors should be vigilant about the dates of defaults and ensure that any actions taken fall within permissible periods under the IBC.

Corporate debtors, on the other hand, must recognise that while acknowledging debts is a step toward resolution, such acknowledgments cannot retroactively alter the classification of defaults that occurred during the exclusion period. This understanding is vital for accurate financial reporting and in formulating strategies for debt resolution.

In essence, the NCLAT's decision reinforces the legislative intent behind Section 10A, ensuring that the exclusion period serves its purpose without being circumvented through post-period acknowledgments. Both creditors and corporate debtors must align their actions with the statutory framework to uphold the integrity of insolvency proceedings.

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