

# JUDGMENT UPDATE

## RESTRUCTURING & INSOLVENCY



## Balance Sheets can amount to acknowledgement of debt

By: Abhirup Dasgupta, Partner & Ishaan Duggal, Senior Associate

### Background facts

- Asset Reconstruction Company (India) Ltd (**ARCIL/Appellant**) filed an Application under Section 7 of the IBC for initiation of Corporate Insolvency Resolution Process (**CIRP**) against Corporate Power Ltd. This Application was admitted by the National Company Law Tribunal, Kolkata Bench (**NCLT**) *inter alia* after observing that the Corporate Debtor had acknowledged its liability in the Balance Sheets before the expiry of limitation period of 3 years from the date of default and thus, the Section 7 Application was not barred by limitation.
- An Appeal was filed against the abovementioned order of admission before NCLAT by Bishal Jaiswal, a suspended director of Corporate Power Ltd. He relied upon the majority opinion in judgment passed by NCLAT in the matter of *V. Padmakumar v. Stressed Assets Stabilisation Fund (SASF) & Anr*<sup>1</sup>, wherein it was held that the entries in a Balance Sheet do not amount to an acknowledgment of debt in terms of Section 18 of Limitation Act. Basis the same, the suspended director contended that Section 7 Application filed by ARCIL was barred by limitation.
- The minority opinion in *V. Padmakumar* was passed after considering various judgments of the Supreme Court (**SC**) and High Courts and consequently, held that entries in a Balance Sheet would amount to an acknowledgment of debt in terms of Section 18 of the Limitation Act.
- The Appeal filed by the suspended director was heard by a three-member bench of the NCLAT. ARCIL contended before the three-member bench that the majority opinion in *V. Padmakumar* was per incuriam since it did not consider the catena of judgments passed by the Supreme Court and the various High Courts which state that entries in a Balance Sheet would amount to an acknowledge of debt in terms of Section 18 of the Limitation Act.
- Vide order dated September 25, 2020, the three-member bench of NCLAT doubted the correctness of the judgment passed by five-member bench of NCLAT in matter of *V. Padmakumar* and in view of the same, observed that *V. Padmakumar* warrants reconsideration for holding that entries in a Balance Sheet do not amount to an acknowledge of debt in terms of Section 18 of the Limitation Act. Accordingly, three-member bench passed a reference order for a five-member bench to be constituted to reconsider majority decision in *V. Padmakumar*.
- Consequently, the reference was listed and heard by the five-member bench. Thereafter, vide judgment dated December 22, 2020 (**Impugned Order**), the five-member bench observed that Section 18 of the Limitation Act would have no application to proceedings under the IBC. It was further observed that the majority opinion of the NCLAT in *V. Padmakumar* was good law.

SC vide judgment dated April 15, 2021 in the matter of *Asset Reconstruction Company (India) Ltd v. Bishal Jaiswal & Anr.* decided a crucial question of law pertaining to whether entries in the Balance Sheet would amount to an acknowledgment of debt for purpose of extending the period of limitation as provided under Section 18 of Limitation Act, 1963 (**Limitation Act**).

In this landmark judgment which is undoubtedly significant to all stakeholders under the Insolvency and Bankruptcy Code, 2016 (**IBC**), the Apex Court took cognizance of the fact that although the filing of a Balance Sheet is a statutory requirement as per the provisions of the Companies Act, 2013, however, doing the same can amount to an acknowledgment of debt depending on the facts of the particular case. This judgment also set aside the majority decision of the National Company Law Appellate Tribunal (NCLAT) in the matter of *V. Padmakumar v. Stressed Assets Stabilisation Fund* wherein the majority opinion of the five-member bench was that entries in Balance Sheets would not amount to an acknowledgment of debt to extend limitation under Section 18 of the Limitation Act.

**HSA Advocates represented ARCIL in this matter before SC and got a favorable order.**

### Our team:



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<sup>1</sup> Company Appeal (AT) (Insolvency) No. 57 of 2020 (decided on March 12, 2020)

- Aggrieved by the Impugned Order passed by the NCLAT, Appellant filed the captioned Appeal before SC. It is pertinent to note that along with the said Appeal, SC also heard other Appeals including an Appeal against the NCLAT's judgment in V. Padmakumar and decided the said matters by applying the law laid down in Asset Reconstruction Company (India) Limited vs. Bishal Jaiswal & Anr<sup>2</sup>

### Issues at hand

- Whether Section 18 of the Limitation Act is applicable to proceedings under the IBC?
- Whether entries in Balance Sheets amount to an acknowledgment of debt to extend limitation under Section 18 of Limitation Act and, whether the majority opinion of the NCLAT in V. Padmakumar was *per incuriam*, as it was passed in ignorance of binding precedents and settled law?

### Findings of the Court

- SC placed reliance on a plethora of judgments passed by the Court including but not limited to Mahabir Cold Storage v. CIT<sup>3</sup>, Jignesh Shah v. Union of India<sup>4</sup>, AV Murthy v. BS Naqabasavanna<sup>5</sup> and judgments passed by various High Courts which observed that entries in a Balance Sheet would amount to an acknowledge of debt in terms of Section 18 of the Limitation Act. Further, the Apex Court also referred to the judgment of the Calcutta High Court in Bengal Silk Mills Co v. Ismail Golam Hossain Ariff<sup>6</sup> and consequently, the Court held that there is no doubt that the filing of a Balance Sheet in accordance with the provisions of the Companies Act, 2013 is mandatory, any transgression of the same being punishable by law. However, there is no compulsion to make any particular admission. Hence, to determine if an acknowledgment of debt is made or not would depend on the facts of each case as to whether an entry made in a Balance Sheet qua any particular creditor is unequivocal or has been entered into with caveats. These caveats could be in the form of notes to accounts or other qualifications made in the Balance Sheets.
- SC also observed that the minority judgment of Justice (Retd.) A.I.S. Cheema, Member (Judicial) in V. Padmakumar has reached the correct conclusion. Accordingly, the Supreme Court set aside the majority view in the V. Padmakumar judgment which held that that entries in a Balance Sheet could not be considered an acknowledgment of debt for the purposes of extending limitation under Section 18 of Limitation Act.
- In addition to the above, SC relied upon its recent decisions in Sesh Nath Singh & Anr v. Baidyabati Sheoraphuli Co-operative Bank Ltd & Anr<sup>7</sup> and Laxmi Pat Surana v. Union Bank of India & Anr<sup>8</sup> and observed that it is not possible to accede to the arguments that Section 18 of the Limitation Act cannot be made applicable to proceedings under the IBC.



#### Our viewpoint

With this judgment, SC has clarified a simple and straightforward proposition that entries in a Balance Sheet can amount to an acknowledgement of debt for the purpose of extending the limitation period under Section 18 of the Limitation Act.

This proposition had been unnecessarily convoluted by contradictory judgments of the NCLAT and the Apex Court has now clarified the factors that need to be taken into account while ascertaining whether an entry in a Balance Sheet would be considered to be an acknowledgment for the purpose of Section 18 of the Limitation Act. One such factor is whether such entries are accompanied by a caveat regarding it being an acknowledgment of debt. This would entail a factual analysis which would have to be undertaken by the Court/Tribunal to finally arrive at a conclusion regarding the application of Section 18 of the Limitation Act. In our opinion, this places the creditors and the debtors on a level playing field and would give the debtors a reasonable opportunity of being heard.

However, the judgment has not addressed a few pertinent aspects:

- The judgment does not deal with the situation wherein the debtor, who has made an entry in its Balance Sheet, also makes a counter claim against the creditor. Though academically speaking, the said situation is clearly dealt with by the explanation of Section 18 of the Limitation Act which provides that the acknowledgment may even be accompanied by a refusal to pay, deliver, perform or permit to enjoy, or is coupled with a claim to set-off. In other words, a counter claim may be relevant for the purpose of considering the overall liability of the debtor, however, it would not be relevant for the purpose of determining whether an entry in a Balance Sheet would be considered to be an acknowledgment for the purpose of Section 18 of the Limitation Act.
- Similarly, this judgment does not answer whether an entry in the "contingent liability" column would amount to an acknowledgement of debt for the purposes of extending the limitation period.
- While this judgment examined the entries in the Balance Sheets only for the purposes of analysing their effect on limitation, the judgment does not consider the effect of the various entries for other purposes such as passing decrees on admission.

While this is a noteworthy judgment that impacts all stakeholders in the IBC ecosystem, especially the Financial Creditors, the pertinent factors would have to be taken into account on a case-to-case basis to determine whether an entry in a Balance Sheet would be considered to be an acknowledgment for the purpose of Section 18 of the Limitation Act.

<sup>2</sup> Civil Appeal No. 323 of 2021

<sup>3</sup> 1991 Supp (1) SCC 402

<sup>4</sup> (2019) 10 SCC 750

<sup>5</sup> (2002) 2 SCC 642

<sup>6</sup> 1961 SCC OnLine Cal 128

<sup>7</sup> Civil Appeal No. 9198 of 2019

<sup>8</sup> Civil Appeal No. 2734 of 2020

