Phoenix Arc Private Limited vs Spade Financial Services Limited on 1 February, 2021

Equivalent citations: AIR 2021 SUPREME COURT 776, AIRONLINE 2021 SC 36

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Bench: Indira Banerjee, Indu Malhotra, Dhananjaya Y Chandrachud

Reportable

IN THE SUPREME COURT OF INDIA
CIVIL APPELLATE JURISDICTION

Civil Appeal No. 2842 of 2020

Phoenix Arc Private Limited .... Appellant

Versus

Spade Financial Services Limited & Ors. .... Respondents

With Civil Appeal No. 3063 of 2020 JUDGMENT Dr Dhananjaya Y Chandrachud, J This judgment has been divided into sections to facilitate analysis. They are:

A The appeals

B CIRP for the Corporate Debtor

C Proceedings before NCLT

D Proceedings before NCLAT

E Transactions of the Corporate Debtor

F Relationship between Anil Nanda and Arun Anand

G Whether Spade and AAA are financial creditors of the Corporate Debtor

I Whether Spade and AAA can be excluded from the CoC I.1 Submissions of Counsel I.2 Related Parties and CoC I.3 Amendment to First Proviso of Section 21(2) I.4 Related Parties - Interpretation In Praesenti J Conclusion PART A A The appeals 1 This judgment would govern two sets of appeals arising from the judgment of the National Company Law Appellate Tribunal ("NCLAT" or "Appellate Tribunal"). By a judgment dated 27 January 2020, NCLAT dismissed the appeal under Section 61 of the Insolvency and Bankruptcy Code, 2016 ("IBC") preferred by AAA Landmark Private Limited ("AAA") and Spade Financial Services Private Limited ("Spade") to assail the order dated 19 July 2019 of the National Company Law Tribunal, New Delhi Bench -III ("NCLT" or "Adjudicating Authority"). The NCLT had held that AAA and Spade have to be excluded from the Committee of Creditors ("CoC") formed in relation to the Corporate Insolvency Resolution Process ("CIRP") initiated against AKME Projects Limited ("Corporate Debtor"). NCLT passed its order dated 19 July 2019 on applications1 filed by Phoenix Arc Private Limited ("Phoenix") and YES Bank under Section 60(5)(c) of the IBC. 2 Phoenix, in Civil Appeal No. 2842 of 2020, submits that though the NCLAT correctly dismissed the appeal filed by Spade and AAA, holding that they are related parties of the Corporate Debtor and are hence to be excluded from the CoC, there is an erroneous finding that they are financial creditors. In paragraph 11 of its judgment, the NCLAT has observed that:

> "...admittedly appellants are the financial creditors of the corporate debtor AKME Projects Limited..." CA No. 337/2018 and CA No. 338/2019 (Phoenix); CA No. 268/2018 and CA No. 269/2018 (Yes Bank).

PART A It has been submitted that there was never any admission on the part of Phoenix that AAA and Spade are financial creditors. The appeal by Phoenix seeks to challenge the above finding on the ground that:

(i) It is contrary to the record; and

(ii) The specific stand of Phoenix is that both AAA and Spade are not even

creditors of the corporate debtor, much less financial creditors.

Phoenix is thus in appeal under Section 62 of IBC, confined to the finding that AAA and Spade are financial creditors.

3 Spade and AAA have independently filed an appeal under Section 62, Civil Appeal No. 3063 of 2020, in order to assail the decision of the NCLAT dated 27 January 2020 affirming their exclusion from participating in the CoC on the ground that they are related parties of the Corporate Debtor in terms of Section 5(24) and the first proviso to Section 21(2) of IBC.

4 Based on the above appeals, three issues have arisen for consideration before this Court:

(i) Whether Spade and AAA are financial creditors of the Corporate Debtor;

(ii) Whether Spade and AAA are related parties of the Corporate Debtor; and

(iii) Whether Spade and AAA have to be excluded from the CoC.

PART B B CIRP for the Corporate Debtor 5 The brief facts of the case are that CIRP has been initiated against the Corporate Debtor on 18 April 2018 on an application filed by an operational creditor, Mr. Hari Krishan Sharma, under Section 9 of IBC. 6 During the CIRP, claims were invited by the Interim Resolution Professional ("IRP"). Spade filed its claim in Form C as a financial creditor for a sum of Rs. 52,96,00,000 on 10 May 2018. Thereafter, Spade filed a revised Form C for a sum of Rs. 109,11,00,000 on 20 May 2018. Spade had filed the form on the basis of an alleged Memorandum of Understanding dated 12 August 2011 executed with the Corporate Debtor, which stated that Inter Corporate Deposits ("ICDs") of Rs. 26,55,00,000 have been granted to the Corporate Debtor by Spade bearing interest of 24% repayable in terms of the mutual agreement between the parties. However, Spade has submitted before this Court that it has granted ICDs of Rs. 66,00,00,000 (approx.) to the Corporate Debtor between June 2009 and January 2013. Out of this amount, Spade is claiming a principal amount of Rs. 23,00,00,000. The balance amount of Rs 43,06,00,000 was credited in the account of AAA, which is a wholly owned subsidiary of Spade. The total claim of Spade has increased to Rs. 109,11,00,000 in 7 years on account of interest at the rate of 24%.

7 AAA filed its claim before the IRP in Form F as a creditor other than a financial creditor or operational creditor for a sum of Rs. 93,90,00,000 on 10 May 2018. Thereafter, AAA filed a revised claim in Form C as a financial creditor for a sum of Rs. 109,72,00,000 on 23 May 2018. It had entered into a Development PART C Agreement dated 1 March 2012 with the Corporate Debtor for a sale consideration of Rs. 32,80,00,000 to purchase development rights in a project. On 25 October 2012, the Development Agreement was terminated and an Agreement to Sell, along with a Side Letter, was executed between AAA and the Corporate Debtor for purchase of flats. The sale consideration for the Agreement to Sell was enhanced to Rs. 86,01,00,000 from Rs. 32,80,00,000 under the Development Agreement. AAA paid a sum of Rs. 43,06,00,000 as advance payment under the Agreement to Sell. This amount was adjusted out of the ICDs payable to Spade as noted above. The claim of AAA is with respect to the principal amount of Rs. 43,06,00,000, which along with interest at the rate of 18% increased to Rs. 109,72,00,000 in 5 years.

8 The CoC was constituted on 22 May 2018. On 25 May 2018, the IRP rejected the claim of Spade, inter alia, on the ground that the claim was not in the nature of a financial debt in terms of Section 5(8) of IBC since there was an absence of consideration for the time value of money, i.e., the period of repayment of the claimed ICDs was not stipulated. The IRP also rejected the claim of AAA on the ground that its claim as a financial creditor in Form C was filed after the expiry of the period for filing such a claim.

C Proceedings before NCLT

9 Aggrieved by the rejection of their claim as financial creditors, AAA and

Spade filed applications before the NCLT to be included in the CoC. The NCLT by its order dated 30 May 2018 allowed the applications. However, none of the other financial creditors, such as Phoenix and YES Bank, were parties to these PART C proceedings. The NCLT observed that AAA's original claim in Form F was filed on time and it has only amended its claim as one under Form C. The NCLT further observed that the amount given by Spade in the form of ICDs has been received as a deposit and is attracting interest as reflected in Form '26 AS', deducting TDS on interest. Thus, NCLT allowed Spade and AAA to submit their claims as financial creditors with a direction to the IRP to consider the claims. 10 Phoenix is also a financial creditor of the Corporate Debtor and is a part of CoC. Its claim is based on a registered Deed of Assignment in its favour dated 28 December 2015, pursuant to which, Karnataka Bank Limited had assigned the non-performing assets relating to the credit facilities granted to the Corporate Debtor. The voting share of Phoenix was reduced to 4.28% on account of AAA and Spade being included in the CoC.

11 On 1 June 2018, a meeting of the CoC took place which was attended by YES Bank and Phoenix, and also by the newly approved financial creditors, AAA and Spade. Following the meeting, YES Bank and Phoenix filed applications in the NCLT for the exclusion of AAA and Spade from the CoC on the ground that they are related parties. Notice was issued by the NCLT in the two applications2. 12 The application moved on behalf of YES Bank under Section 60(5), on 28 June 2018, sought the following reliefs:

> (i) A direction to the IRP to reconstitute the CoC in terms of the Insolvency and Bankruptcy (Amendment) Ordinance 2018 ("IBC Ordinance 2018");

and Civil Appeal No. 267/2018 and Civil Appeal 368/2018 PART C

(ii) A direction prohibiting the IRP from allowing AAA and Spade to participate and vote in the meeting of the COC.

13 The applications filed under Section 60(5) by Phoenix also sought similar reliefs for:

(i) The removal of Spade and AAA from the CoC; and

(ii) Directing the constitution of the CoC in terms of the IBC Ordinance 2018. 14 NCLT in its judgment dated 19 July 2019 formulated two issues for determination. These two issues were:

> "i. What is the nature of the transaction between the parties and does it qualify to be treated as financial debt as defined under Section 5(8) of IBC, 2016.
>
> ii. What is the date on which there should be relation between the two parties for the alleged Financial Creditor to be included in the definition "related party'."

15 In relation to the first issue, the NCLT held that:

> "...the transactions between CD and both SPADE and AAA Landmark are collusive in nature and do not qualify as financial debt for the purpose of IBC." Accordingly, NCLT held that Spade and AAA did not qualify to be considered as financial creditors.

16 In relation to the second issue, NCLT held that it "does not require a reply" in view of its above-mentioned finding. However, it took note of the first proviso to Section 21(2) of the IBC, which was introduced with effect from 6 June 2018. Under the first proviso, inter alia, a financial creditor who is a related party of the PART D corporate debtor shall not have the right of representation, participation or voting in the CoC. The Adjudicating Authority held that "there is no doubt in our mind that Arun Anand and his company namely Spade and AAA Landmark were related parties to the CD". However, the NCLT noted that after 2013, soon after the execution to the Agreement to Sell of 25 October 2012, Arun Anand resigned from all the companies of the Anil Nanda Group and was no longer related to the Corporate Debtor at the time of the filing of the application for initiation of the CIRP. Ultimately, the Adjudicating Authority held that there was a deep entanglement between the affairs of the corporate debtor and the group representing the Arun Anand companies which could not be unravelled in the summary jurisdiction before the Tribunal. The ultimate decision of the NCLT was to allow the applications filed by YES Bank and Phoenix for the exclusion of AAA and Spade from the CoC based on its findings on the first issue.

D Proceedings before NCLAT

17 In appeal, the NCLAT proceeded in paragraph 11 of its decision to observe

that "admittedly" Spade and AAA "are the financial creditors of the corporate debtor". Having stated so, the Appellate Tribunal proceeded to enquire into whether AAA and Spade are related parties within the meaning of Section 5(24) of the IBC.

18 Answering the above issue in the affirmative, the NCLAT held that Spade and AAA are related parties of the Corporate Debtor since:

> PART D
>
> (i) AAA was a partner of the Corporate Debtor in accordance with Section 5(24)(a)3. The Appellate Tribunal held that since even after the cancellation of Development Agreement dated 1 March 2012 between the parties, they had entered into an Agreement to Sale and Side Letter dated 25 October 2012, which was merely a camouflage under which they were partners in developing a residential project to be sold to a third party;
>
> (ii) In accordance with Section 5(24)(f)4, during the transaction period of 2010 to 2013, Spade led by Mr Arun Anand was making substantial financial arrangements on the basis of advice provided by the Corporate Debtor led by its Management and Directors, i.e., Mr. Anil Nanda (a promoter of the Corporate Debtor) and Mr Sonal Anand (Mr Arun Anand's brother in-law). In particular, the Appellate Tribunal noted the following two arrangements between Spade and the Corporate Debtor:
>
> (a) Memorandum of Understanding dated 2 December 2010, through which Spade, on behalf of the Corporate Debtor, paid a third party Rs. 22 crores as ICD and donated Rs. 3 crores to another third-party trust; and
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> (b) Between 16 and 17 January 2013, the Anil Nanda Group of Companies (led by Mr. Sonal Anand) sought to settle its debts with a third party (worth Rs. 2 crores) through funds parked with Spade;

"(a) a director or partner of the corporate debtor or a relative of a director or partner of the corporate debtor;" "(f) anybody corporate whose board of directors, managing director or manager, in the ordinary course of business, acts on the advice, directions or instructions of a director, partner or manager of the corporate debtor;" PART D

(iii) In accordance with Section 5(24)(h)5, the Corporate Debtor was acting on the directions/instruction of Mr. Arun Anand who, along with his family, is the majority shareholder in Spade, of which AAA is a wholly-owned subsidiary. The Appellate Tribunal came to this conclusion on the basis that:

(a) on 1 June 2009, Spade was appointed as 'Consultant' to the Corporate Debtor till 21 February 2011;

(b) from 1 November 2011, Mr. Arun Anand was appointed as a 'Strategic Advisor' to the Corporate Debtor;

(c) from 26 November 2012, Mr. Arun Anand was appointed as Group CEO of the Anil Nanda Group of Companies, which included the Corporate Debtor;

and

(d) during this period, the first ICD was given by Spade to the Corporate Debtor;

(iv) On the basis of the same reasons as (iii), Mr. Arun Anand was also held to be a person participating in the policy-making process of the Corporate Debtor in accordance with Section 5(24)(m)(i)6;

(v) Mr. Arun Anand and Mr. Sonal Anand were directors of the Corporate Debtor till 2013. Hence, Mr. Arun Anand would be a related party under Section 5(24)(a) read with 5(24A)(a)7, being a relative of another director; and "(h) any person on whose advice, directions or instructions, a director, partner or manager of the corporate debtor is accustomed to act;" "(m) any person who is associated with the corporate debtor on account of— (i) participation in policy-making processes of the corporate debtor;" "(24-A) "related party", in relation to an individual, means— (a) a person who is a relative of the individual or a relative of the spouse of the individual;" PART E

(vi) A holding company of the Corporate Debtor, Joint Investment Private Limited ("JIPL"), holds shareholding in Spade.

19 Hence, NCLAT came to the conclusion that the Adjudicating Authority had rightly excluded both Spade and AAA from participation in the CoC since Mr. Anil Nanda, in concert with Mr. Arun Anand and his family, had created a web of companies which were related parties to the Corporate Debtor, and was now trying to gain a backdoor entry into the CoC through them.

E Transactions of the Corporate Debtor

20 Before we proceed with our analysis of the issues, it is important to note

the relevant transactions between the Corporate Debtor on one hand and Spade and AAA on the other hand, which gives rise to their claims as financial creditors. 21 The following transactions between the Corporate Debtor and Spade are relevant for our consideration:

(i) Memorandum of Understanding dated 12 August 2011, through which Spade provided the Corporate Debtor with ICDs worth a net amount of Rs.

66 crores from 1 June 2009 till January 2013, which provided for 24% interest. However, Spade has stated that in actuality only 12% interest was charged and hence its claim is on that basis;

(ii) Through this Memorandum of Understanding, the Corporate Debtor provided security for these ICDs through 37 flats worth Rs. 39.825 crores in their real estate project, AKME RAAGA. Further, through emails dated 16 and 17 January 2012, additional security was provided through 11 plots PART F worth Rs. 3 crores in the Corporate Debtor's real estate project, AKME POLIS. The charge was not registered; and

(iii) Out of the ICDs provided to the Corporate Debtor by Spade, Rs. 43.06 crores' worth were credited to the account of Mr. Arun Anand by consent. However, this has been disputed by Spade.

22 The following transactions between the Corporate Debtor and AAA are relevant for our consideration:

> (i) Development Agreement dated 1 March 2012, through which the Corporate Debtor sold to 38.3% of its development rights in its real estate project, AKME RAAGA, to AAA for a consideration of Rs. 32.80 crores;
>
> (ii) Agreement to Sell dated 25 October 2012, which superseded the Development Agreement dated 1 March 2012, through which AAA bought a saleable area of 313,928 sq. ft. in AKME RAAGA at a price of Rs. 43.06 crores; and
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> (iii) Side Letter dated 25 October 2012, which was to be read as a part of the Agreement to Sell, which noted that the area bought by AAA was 38.3% of AKME RAAGA, and AAA would provide for the cost of its development accordingly.

F Relationship between Anil Nanda and Arun Anand 23 It is also important to note the close relationship between the key managerial personnel of the Corporate Debtor, Mr. Anil Nanda and the director of Spade and AAA, Mr. Arun Anand:

> PART F
>
> (i) Mr. Anil Nanda is the major shareholder of JIPL, which holds 80% of the shareholding in the Corporate Debtor;
>
> (ii) The Corporate Debtor is a part of the Nanda Group of Companies;
>
> (iii) Mr. Arun Anand was also a director of the Corporate Debtor up to 31 March 2002;
>
> (iv) Mr. Arun Anand and his son, Mr. Aditya Anand, sold their shareholding in the Corporate Debtor in the year 2004/2005;

(v) Mr. Arun Anand was also closely related to one of the directors of the Corporate Debtor, Mr. Sonal Anand, who is his brother-in-law. Sonal Anand was the director of the Corporate Debtor from November 2007 to 2013; and

(vi) Mr. Arun Anand has worked in different capacities for Mr. Anil Nanda for about 25 years.

24 The purported transactions took place when he was an employee of Escorts Limited/Nanda Group of Companies, including the Corporate Debtor and also held key managerial posts in the said companies. Spade and AAA, in their written submissions, have given details of Mr Arun Anand's association with the Corporate Debtor during the relevant period (June 2009 to January 2013) and thereafter:

1 June 2009 – 31 October 2011 Consultant 1 November 2011 – 25 November Strategic Advisor PART G 26 November 2012 – 14 February Group CEO 2013 (81 days) 15 March 2013 till 18 April 2018 Since February 2013, Mr. Arun (CIRP date) Anand has no association with Corporate Debtor in any manner whatsoever G Whether Spade and AAA are financial creditors of the Corporate Debtor G.1 Submission of Counsel

25 The learned Senior Counsel who appeared in these proceedings on behalf of the contesting parties are:

(i) Mr K.V. Viswanathan for AAA and Spade;

(ii) Mr Neeraj Kishan Kaul for Phoenix; and

(iii) Mr Sanjiv Sen for the Resolution Professional ("RP").

26 The submission of Mr K V Viswanathan is that NCLT held against AAA and

Spade on the ground that they were not financial creditors. In view of this finding, the NCLT held that it was not necessary to enter upon the second issue which it had formulated. On the other hand, NLCAT in appeal proceeded on the basis that admittedly AAA and Spade are financial creditors but then went on to hold that they are related parties and are therefore liable to be excluded from the CoC. His submission is three-fold:

PART G

(i) The issue as to whether Spade and AAA are financial creditors was concluded by the earlier order of the NCLT dated 31 May 2018 which operates as res judicata. NCLT having allowed the applications of AAA and Spade for submitting their claims to the IRP as financial creditors, this finding could not have been altered in the subsequent order dated 19 July 2019. The NCLT in its order dated 31 May 2018 gave

a categorical finding that the amount received by the Corporate Debtor in the form of deposits by Spade and AAA are financial debts and the IRP's rejection of their claim was unsustainable;

(ii) The subsequent applications filed by YES Bank and Phoenix before the NCLT only sought a re-constitution of the CoC and to restrict Spade and AAA from representing, participating or voting in the CoC. The issue in respect of the eligibility of Spade and AAA as financial creditors was never raised in their applications. The only issue raised before the NCLT was with respect to Spade and AAA being related parties of the Corporate Debtor. However, NCLT framed two issues including the one relating to Spade and AAA's eligibility as financial creditors which stood decided on 31 May 2018; and

(iii) In the appeal filed by AAA and Spade against the decision of the NCLT to exclude them from the CoC, the only issue which fell for consideration was whether they were financial creditors. In other words, it was only the correctness of the determination of the Adjudicating Authority that they were not financial creditors which was moot, for being considered. The NCLAT proceeded to dismiss the appeal, despite its finding that PART G "admittedly" AAA and Spade are financial creditors by coming to the conclusion that they are related parties.

27 On the basis of the above submissions, Mr Viswanathan has submitted that the proceedings should be remanded back for reconsideration since the NCLAT has made an error of jurisdiction in rejecting the appeal filed by AAA and Spade despite having agreed with their submission that they are financial creditors.

28 The submission of Mr Neeraj Kishan Kaul is that AAA and Spade are not creditors of the Corporate Debtor, much less financial creditors, in terms of Section 5(7) of the IBC. The submissions made in relation to the transaction between AAA and the Corporate Debtor are:

(i) The Development Agreement dated 1 March 2012 entered between AAA and the Corporate Debtor was collusive. AAA had sought to purchase 38.3% of the development rights in a project called AKME RAAGA as a co-

developer/partner. However, the development license granted by the Government could not be sub-divided. As a result, the Corporate Debtor and AAA converted the Development Agreement into an unregistered Agreement to Sell dated 25 October 2012;

(ii) AAA and the Corporate Debtor executed an unlawful Side Letter dated 25 October 2012 with the intention to co-develop the land and sell it in the market. The Side Letter contained terms akin to the terms which were a part of the Development Agreement. It contained terms for sharing of costs of development of the project relating to cost of land, construction, license PART G and approvals, manpower, liaison cost etc. and the assigning of responsibilities for compliance. The intent of the parties was to circumvent the laws, government policies and regulations to continue developing the

project; and

(iii) Initially, Mr Arun Anand as a director of AAA had filed its claim before the IRP accepting that it is neither a financial creditor nor an operational creditor. However, as an afterthought, Mr. Arun Anand filed a baseless, unlawful, and augmented revised claim as a financial creditor. AAA's claim of being a financial creditor is mala fide and dishonest, and was filed only with the intention of manipulating the voting percentage of CoC. 29 Mr Kaul's submissions in relation to the eligibility of Spade to be a financial creditor are:

> (i) Spade has concealed the real nature of the collusive transactions and had filed an unlawful claim as a financial creditor for an amount of Rs.

52,96,00,000. Spade filed a revised claim as a financial creditor exaggerating the amount it was claiming to Rs. 109,11,00,000 without any basis. The claim was filed by Spade on the basis of an alleged Memorandum of Understanding dated 12 August 2011. Clause 2 of the Memorandum of Understanding provides:

> "whereas Spade has granted inter-corporate loan to AKME and other companies on behalf of AKME to the extent of Rs. 26.55 Crores (ICD) bearing an interest of 24% repayable as per mutual agreement between parties." PART G The Memorandum of Understanding is unenforceable, collusive and is merely an eye-wash. An amount of only Rs. 26.55 Crores was allegedly advanced to Spade and "other companies". No Board resolution was passed by Spade approving the grant of ICDs of Rs. 26.55 Crores. In any case, the alleged claim is grossly time barred; and
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> (ii) The claim of Spade was rejected by the IRP in a letter dated 25 May 2018 on the following basis:
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> (a) The essential element of a financial debt in terms of Section 5(8) of the IBC is absent, which is the consideration for the time value of money. The exact period of repayment of the ICDs has not been stipulated in the Memorandum of Understanding;
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> (b) The calculation sheet provided by Spade to ascertain the interest rate and payment of interest does not reflect adjustment of any part of payment against the payment of interest;
>
> (c) The ledger provided by Spade does not stipulate the interest claimed on the alleged debt;
>
> (d) ICDs were allegedly granted to the Corporate Debtor by Spade in 2013; however, no valid financial contract was entered between the Corporate Debtor and Spade to stipulate the consideration in terms of the time value of money against each transaction. A financial contract is essential for considering a debt as financial debt;

(e) The calculation sheet reflects that the inflow and outflow of funds are in the nature of a running account, indicating that the debit and PART G credit balances lack any commercial effect of borrowing, which is an essential element in terms of Section 5(8)(f) of IBC; and

(f) The emails relied on by Spade dated 16/17 January 2013 mention that documents in relation to an extension of a loan of Rs. 2 Crores were to be executed. No such documents have been produced on record.

G.2 Assessment of preliminary submissions

G.2.1 Res Judicata

30 In order to appreciate the line of submissions carefully propounded by Mr K V Viswanathan, it becomes necessary to sift through the facts. Initially, on 31 May 2018, an order was passed by the NCLT allowing AAA and Spade to submit their claims as financial creditors with a direction to the IRP to consider the claims. However, when the NCLT allowed AAA and Spade to re-submit its claims as financial creditors, none of the creditors on the CoC were represented in the proceedings. After the meeting on 1 June 2018, Phoenix and YES Bank moved applications under Section 60(5)8 of the IBC for seeking the exclusion of AAA and Spade from the CoC on the ground that they were related parties.

31 In this backdrop, we are unable to subscribe to the submission that the order of the NCLT dated 31 May 2018 operated as res judicata. The order was "(5) Notwithstanding anything to the contrary contained in any other law for the time being in force, the National Company Law Tribunal shall have jurisdiction to entertain or dispose of—

(a) any application or proceeding by or against the corporate debtor or corporate person;

(b) any claim made by or against the corporate debtor or corporate person, including claims by or against any of its subsidiaries situated in India; and

(c) any question of priorities or any question of law or facts, arising out of or in relation to the insolvency resolution or liquidation proceedings of the corporate debtor or corporate person under this Code." PART G passed without hearing financial creditors such as Phoenix and YES Bank. Hence, they were legitimately within their rights in seeking a direction for the exclusion of AAA and Spade from the CoC, if they were aggrieved by the terms of that order. The earlier order was passed without furnishing them with an opportunity of being heard.

G.2.2 Issues before NCLAT 32 Mr Viswanathan's submission that the issue of the eligibility of Spade and AAA as financial creditors was never raised before the NCLT is contrary to the material produced on record. The application filed by Phoenix adverted to its submission that NCLT's order

dated 31 May 2018 was obtained by Spade and AAA on a concealment of material facts, circumstances and the real nature of the transactions. In addition, Mr Anil Nanda, the suspended director of the Corporate Debtor, had filed an application9 before the NCLT alleging that Spade and AAA have not financed any amount to the Corporate Debtor. He submitted that there was no loan facility against the time value of money. In addition, he argued that the Agreement to Sell between the Corporate Debtor and AAA was a part of series of acts of fraud, and is null and void. The NCLT's order dated 19 July 2019 was passed after arguments were led on the real nature of transactions between the parties.

CA -224/ND/2018 PART G G.2.3 Remand to NCLAT 33 The submission that the NCLAT has acted beyond jurisdiction in the appeal filed by AAA and Spade in enquiring into whether they are related parties is the next aspect which needs to be considered. NCLT in its decision on 19 July 2019 had formulated two questions for consideration. The first was whether the transactions between AAA and Spade qualify to be treated as a financial debt under Section 5(8). The second pertained to the date with reference to which the relationship between the parties needs to be considered for assessing whether they are related parties. On the first aspect, the adjudicating authority came to the conclusion that the transaction between the corporate debtor and Spade is not a financial debt under Section 5(8) and Spade is not a financial creditor under Section 5(7). The basis of this finding is contained in paragraph 11.2 of the decision, which is extracted below:

> "11.2 Perusal of the documents pertaining to the inter corporate deposit stated to have been given by Spade Financial Services Private Limited to the Corporate Debtor from 01.06.2009 to January 2013 shows the following points of interest:
>
> Though the loan was given from June 2009 to January 2013, the MOU regarding the same is dated 12.08.2011 The said MOU provided for interest at the rate of 24°/o but it is stated that only 12°/o interest was paid on mutual agreement.

In the claim filed before the RP only 12% interest has been claimed Though securities were provided by way of flats and plots in the real estate projects of the Corporate Debtor, the charge of the "Secured loan" was not registered with the Registrar of Companies.

No Board Resolutions approving deposit of such inter corporate deposits and their acceptance by the Corporate Debtor have been filed before us.

Out of the ICD of Rs. 66 crores given by Spade to the CD, Rs. 43.06 crores are stated to have been credited PART G to the account of Arun Anand, Director of CD, by consent.

The above facts show that the transaction pertaining to giving of inter corporate deposits by Spade to CD appears to be collusive, as the MOU for the same has been signed more than two years after the beginning of the transaction, and the rate of interest actually stated to be charged is half of the interest mentioned in the MOU, as also a major portion of the ICD was credited to the account of Arun Anand, Director of Spade. Thus, it is seen that the entire amount was not disbursed to the CD as well as there is variation in the consideration for the time value of money as per the MOU and

claim filed before the IRP. Accordingly, this transaction does not qualify as a financial debt as defined under Section 5(8) of the Code, and Spade Financial Services Limited does not qualify as a Financial Creditor under Section 5(7) of the Code." Similarly, the transactions between corporate debtor and AAA were discussed in paragraph 11.3 and a finding was arrived at to the effect that they were collusive in nature, and did not qualify as a financial debt. Paragraph 11.3 is extracted below:

> "11.3 The details of transaction and entered by CD with AAA Landmark have been discussed in detail in Para 4.3 above. It is seen that as regards to the same property the parties entered into several agreements over a period of 3 years, including plot buyers Agreement, MOU, Development Agreement and finally, Agreement to Sell dated 25.10.2012. By the Development Agreement dated 01.03.2012, 38.3% of the Development rights of the Project named "AKME Raaga"
>
> were sold to AAA for 32.80 crores and subsequently on 25.10.2012 the Agreement to Sell was executed to superseding the development agreement with an enhanced value of Rs. 43.06 crores. The multiplicity of Agreements regarding the same property, with no explanation or rational reasoning regarding variation in values of transaction, shows that these transactions are also collusive in nature and an attempt to divert the properties of the CD to AAA for reasons best known to the parties. It is also noted that the transactions between the CD and AAA as well as Spade were done during the period when Arun Anand, who along with his family members is the promoter and director of both Spade and AAA Landmark was associated in various capacities from 1982 to 2013 with the CD and its directors and the group of PART G companies to which the CD belongs. It is during this period only that Mr. Arun Anand promoted and subscribed to the memorandum of association of the CD, Spade and AAA Landmark. Mr. Arun Anand and his family members at various points of time also had shareholding in the group companies of the Mr. Anil Nanda group. It is also seen that the alleged financial transactions of Spade and AAA Landmark with the CD occurred during the period 2009 to 2013, the time when he was consultant (through Spade) to the CD, and was consultant and strategic advisor in his individual capacity to the CD and finally group CEO of the Mr. Anil Nanda group of companies. Considering the above facts, we are of the opinion that the transactions between the CD and both Spade and AAA Landmark are collusive in nature and do not qualify as Financial Debt for the purposes of IBC. Accordingly, we hold that Spade and AAA Landmarks do not qualify to be considered as Financial Creditors."

34 Having held that the transactions between the corporate debtor on one hand and AAA and Spade on the other did not qualify as a financial debt, the Adjudicating Authority commenced its discussion on the second issue by stating that it "does not require a reply" in view of the finding on the first issue. However, it then noted that the first proviso to Section 21(2) has been substituted with effect from 6 June 2018, the effect of which is to exclude a financial creditor who is a related party of the corporate debtor from being represented in and from participating or voting in a meeting of the CoC. After adverting to the definition of the expression 'related party' in Section 5(24), the Adjudicating Authority held:

> "There is no doubt in our mind that Arun Anand and his companies, namely, Spade and AAA Landmark were related parties to the CD. However, after 2013 (soon after signing the Agreement to Sell signed on 25.10.2012) Arun Anand resigned from all the companies of The Anil Nanda Group and so they are no longer related to the CD at the time of filing of application of CIRP."

35 Eventually, the NCLT concluded that the applications filed by YES Bank and Phoenix would have to be allowed. Its conclusion is extracted below:

> PART G "13. Before parting with this application, we would like to observe that the affairs of the CD as well as the Group of Arun Anand companies are deeply entangled and it is difficult for the Tribunal in a summary jurisdiction to unravel-the same. Considering that the CD and Spade and AAA were Registrar of Companies since 2016, we have no hesitation in allowing the instant applications filed by Yes Bank Limited and Phoenix ARC Private Limited."

36 The above analysis of the decision of the NCLT indicates that its primary finding was that neither AAA nor Spade are financial creditors within the meaning of Section 5(8).

37 Sub-sections (1) and (2) of Section 21, insofar as is material provide as follows:

> "21. Committee of Creditors.- (1) The interim resolution professional shall after collation of all claims received against the corporate debtor and determination of the financial position of the corporate debtor, constitute a committee of creditors.
>
> (2) The committee of creditors shall comprise all financial creditors of the corporate debtor: Provided that a related partyto whom a corporate debtor owes a financial debt shall not have any right of representation, participation or voting in a meeting of the committee of creditors."

38 Sub-section (2) of Section 21 stipulates that the CoC is to comprise of all financial creditors of the corporate debtor. The first proviso to Sub-section (2) has been amended by Act 26 of 2018 with effect from 6 June 2018. Having held that AAA and Spade are not financial creditors, NCLT came to the conclusion that they were not entitled to inclusion in the CoC.

39 On the second issue, the Adjudicating Authority was of the view that it was not really necessary for it to consider what should be the date with reference to PART G which a related party should be determined. But it is evident that the NCLT did come to the conclusion that Mr. Arun Anand and his various companies namely AAA and Spade were related parties to the corporate debtor though after 2013, Mr Arun Anand resigned from all the companies of the Anil Nanda Group. The Adjudicating Authority observed that they are no longer related to the corporate debtor at the time of the filing of the application for initiation of the CIRP. It noted the deep entanglement of the affairs of the corporate debtor and the Arun Anand group of companies, the close business relationship of the past and the fact that the accounts of the corporate debtor had not been finalised, audited or filed

with the Registrar of Companies since 2016. Reading the order of the NCLT as it stands, it is not possible to accept the submission that the applications filed by YES Bank and Phoenix were rejected only on the basis that they were not financial creditors and that there was no determination in regard to their status as related parties. In light of the above discussion, we do not agree with the submission that NCLAT exceeded its jurisdiction by considering the second issue relating to the determination of the status of AAA and Spade as related parties. Thus, we hold that there is no reason to remand the matter to NCLAT for reconsideration. An order of remand cannot be passed in a routine manner, and it should be passed only if a re-consideration is necessary. An unwarranted order of remand does not serve the cause of justice and merely extends the life of litigation. Remands in commercial matters should not become a ruse to subserve litigation luxuries.

40 The dispute fell into a quagmire when the NCLAT proceeded on the basis that it was an admitted position that AAA and Spade are financial creditors. The PART G finding of fact in paragraph 11 of the decision of the NCLAT that this is the "admitted position" is plainly erroneous since there was an express finding of the NCLT to the contrary. The fact that it necessitated an appeal by AAA and Spade would indicate that this was not an admitted position. It is also evident from the contents of the appeal filed by Spade and AAA, and the reply filed by Phoenix before the NCLAT, that the status of Spade and AAA as financial creditors was in dispute. Having said that, the issue that now falls for our consideration is whether AAA and Spade can be considered as financial creditors. G.3 Analysis G.3.1 Relevant Provisions 41 Section 5 (7) of the IBC defines a financial creditor :

> "(7) "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;"

42 Section 5(8) of the IBC provides a definition of financial debt in the following terms:

> "(8) "financial debt" means a debt along with interest, if any, which is disbursed against the consideration for the time value of money and includes--
>
> (a) money borrowed against the payment of interest;
>
> (b) any amount raised by acceptance under any acceptance credit facility or its de-materialised equivalent;
>
> (c) any amount raised pursuant to any note purchase facility or the issue of bonds, notes, debentures, loan stock or any similar instrument;
>
> (d) the amount of any liability in respect of any lease or hire purchase contract which is deemed as a finance or capital PART G lease under the Indian Accounting Standards or such other accounting standards as may be prescribed;
>
> (e) receivables sold or discounted other than any receivables sold on non-recourse basis;

> (f) any amount raised under any other transaction, including any forward sale or purchase agreement, having the commercial effect of a borrowing;

Explanation.-- For the purposes of this sub-clause,--

(i) any amount raised from an allottee under a real estate project shall be deemed to be an amount having the commercial effect of a borrowing; and

(ii) the expressions, "allottee" and "real estate project" shall have the meanings respectively assigned to them in clauses

(d) and (zn) of section 2 of the Real Estate (Regulation and Development) Act, 2016 (16 of 2016);]

(g) any derivative transaction entered into in connection with protection against or benefit from fluctuation in any rate or price and for calculating the value of any derivative transaction, only the market value of such transaction shall be taken into account;

(h) any counter-indemnity obligation in respect of a guarantee, indemnity, bond, documentary letter of credit or any other instrument issued by a bank or financial institution;

(i) the amount of any liability in respect of any of the guarantee or indemnity for any of the items referred to in sub- clauses (a) to (h) of this clause;" 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 disbursal against consideration for the time value of money. This Court, speaking through Justice Rohinton F Nariman, in Swiss Ribbons Pvt. Ltd. v. Union of India10 has held:

> (2019) 4 SCC 17 PART G "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 "disbursal" in Pioneer Urban Land and Infrastructure Ltd vs. Union of India11 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 "disbursal" 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) (2019) 8 SCC 416 PART G

45 The report of the Insolvency Law Committee dated 26 March 2018 has discussed the interpretation of the term "time value of money" and stated:

"The current definition of 'financial debt' Under Section 5(8) of the Code uses the words "includes", thus the kinds of financial debts illustrated are not exhaustive. The phrase "disbursed against the consideration for the time value of money" has been the subject of interpretation only in a handful of cases under the Code. The words "time value"

have been interpreted to mean compensation or the price paid for the length of time for which the money has been disbursed. This may be in the form of interest paid on the money, or factoring of a discount in the payment." (emphasis supplied) 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 [1967] 2 QB 786 PART G 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)

47 This Court, in Prem Chand Tandon vs. Krishna Chand Kapoor,13 had to determine whether a usufructuary mortgage was a sham transaction entered into by the respondent there (the borrower) to avoid payment to creditors. This Court examined the real nature of the transaction to hold that the parties entered the transaction with an ulterior motive. Justice A.N. Grover, speaking for this Court, held:

> "As regards the consideration for the usufructuary mortgage the promissory notes were never produced. It is true that there was some evidence that Smt. Dhanta Devi [lender] had received certain insurance monies on the death of her husband but the 'aggregate of those amounts did not exceed, Rs. 13,000/-. Even if she was possessed of some jewellery and other funds it is difficult to believe that she would have (1973) 2 SCC 366 PART G advanced such a substantial amount of Rs. 25,000/- to the respondent [borrower] by means of two promissory notes on December 10, 1919 and on March 17, 1920. It would further appear and some stress has been laid on this aspect by Jagat Narain J., in his judgment that the financial , position of the respondent at the time the usufructuary mortgage deed was executed was fairly good considering the various articles like diamonds and the car which he had purchased apart from the shares. The house at Ajmer and the Vile Parle land had been mortgaged with possession for Rupees 25,000/- for a period of 60 years. It was difficult to believe that the respondent would have entered into such a transaction in view of his financial position in the year 1921. It was equally not likely that a person dealing in shares who would require ready money would lock up his assets like the property in dispute in a transaction which was such that the mortgage could not be redeemed before the expiry of the period of sixty years. The mortgage, therefore, was executed only with an ulterior purpose, it being wholly fictitious." (emphasis supplied)

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. PART G G.3.4 Spade and AAA 49 Mr Kaul argued that the transactions entered into between the Corporate Debtor and Spade and AAA are collusive in nature and do not constitute a financial debt. Mr Viswanathan has urged that the eligibility of Spade and AAA as financial creditors has conclusively been determined by the NCLT in its order dated 31 May 2018. We have already concluded that the above order would not operate as res judicata and it was within the jurisdiction of the NCLT to consider this issue afresh. NCLT in its order dated 19 July 2019 has undertaken a detailed analysis of the transactions to arrive at a finding that the transactions were collusive. We are inclined to agree with the findings of the NCLT in its order dated 19 July 2019. NCLAT has also made an observation that "we are of the considered opinion that Mr Anil Nanda, Mr Arun Anand had created a web of companies in which both along with near and dear ones including Ms Renu Anand (Wife of Mr. Arun Anand) and Mr Sonal Anand (Brother-in-law of Mr. Arun Anand) acted in concert with each other"14. It is to be noted that M/s Ernst & Young were appointed as forensic/transactional auditors by the RP on 19 November 2019. Their report contains significant findings:

> "Considering the above transactions, we were unable to understand the business rational of:
>
> Purchase and sale transaction with Spade Financial resulting in a loss of approx. INR 2.12 Cores to CD Rent paid to Arun Anand and Aditya Anand ICD balance of Spade Financial being transferred to AAA Landmark against which sale agreement was executed Basis of valuation of the land transaction and sale of property to AAA Landmark Paragraph 18 PART G EY Comments:
>
> > Reference to Section 66 of the Insolvency and Bankruptcy Code, 2016
>
> Section 66 of the Insolvency and Bankruptcy Code, 2016 Section 66 (1) if during the corporate insolvency resolution process or liquidation process, it is found that any business of the corporate debtor has been carried on with intent to defraud the creditors of the corporate debtor or for any fraudulent purposes, the Adjudicating Authority may on the application of the resolution professional pass an order that any person who were knowingly parties to carrying on of the business in such manner shall be liable to make such contributions to the assets of the corporate debtor as it may deem fit.
>
> Considering the above facts and when read in reference with Section 66 of the Insolvency and Bankruptcy Code, 2016, indicates an intent to defraud the creditors and may be categorized as potentially fraudulent. However, the RP shall make an independent assessment whether it intends to file an application for the same with the Adjudicating Authority as mentioned in the Insolvency and Bankruptcy Code."

(emphasis supplied) 50 As noted by NCLT, the Memorandum of Understanding dated 12 August 2011, on the basis of which Spade had filed its claim in Form C before the IRP, was signed two years after the commencement of the purported transaction. The execution of the Memorandum of Understanding was sought to be explained on the basis that a formal document was created for specifying the rate of interest on the ICDs given by Spade to the Corporate Debtor. However, despite the creation of a formal document, the rate of interest being charged on the ICDs was 12% as mentioned in the claim before the IRP, which is half of the interest rate of 24% stipulated in the Memorandum of Understanding. During the arguments, Mr Kaul and Mr Sen have also brought to the notice of this Court that the Memorandum of Understanding is unregistered and unstamped. The IRP in his letter dated 25 PART G May 2018 has noted that as per the ledger provided by Spade, no interest was claimed on the alleged debt and no adjustment was made regarding the payment of principal or interest by the Corporate Debtor to Spade. It has been submitted in the written submissions filed on behalf of Spade and AAA that the auditors of the Corporate Debtor had been putting a note in its balance sheets stating that the interest of 12% was not being paid to Spade due to a dispute. This submission in fact further fortifies the finding of the IRP that no interest has been paid on the alleged loan. The IRP has also noted in his letter that the Memorandum of Understanding does not stipulate the period of repayment. Hence, the consideration for time value of money is absent, which is an essential ingredient of a financial debt. The NCLT has also noted that a major portion of the ICDs was credited in the account of Mr Arun Anand holding that the entire amount was not “disbursed” to the Corporate Debtor. NCLAT has also made a similar finding in paragraph 11(i) of its judgement. This finding has been disputed by Mr Vishwanathan who argued that no amount of the ICDs has been credited to the account of Mr Arun Anand and such an allegation has not been made by any of the parties including the RP. However, it is to be noted under Clause 2 of the Memorandum of Understanding, the amount of Rs. 26.55 Crores has been disbursed not only to the Corporate Debtor but also to “other companies on behalf of AKME”. In any event, the entirety of the ICDs were not disbursed to Spade. Additionally, no Board resolution was passed by Spade approving the grant of ICDs and the charge created on the loan was not registered with the Registrar of Companies. In view of the above, we are inclined to agree with Mr Kaul that the Memorandum of Understanding was an eye-wash and collusive.

PART G 51 NCLT in its order dated 19 July 2019 has noted that AAA and the Corporate Debtor had entered into multiple agreements regarding the same property without giving any explanation or rationale regarding variation in the consideration. This showed that the transactions were collusive in nature entered with the purpose of diverting properties of the Corporate Debtor to AAA. Mr Viswanathan sought to explain the multiple agreements, and argued that AAA entered into a Development Agreement dated 1 January 2012 with the Corporate Debtor to obtain 38.3% of development rights. Since the Development Agreement could not be implemented because the license for the project could not be split into two parts, an Agreement to Sell and a Side Letter were executed on 25 October 2012. The Agreement to Sell was entered to purchase FSI/flats equivalent to

38.3% of the total FSI in relation to specific units identified and allotted in the agreement. Apparently, the sale consideration was re-negotiated and enhanced from Rs 32.80 crores under the Development Agreement to Rs 86.01 crores under the Agreement to Sell. Mr Viswanathan has submitted that there was no partnership clause in the Agreement to Sell. However, Clause 3 of the Side Letter dated 25 October 2012 shows that the intent of the parties was to continue to co-develop the land. Clause 3 of the Side Letter provides:

> "3. It is agreed that ALPL shall share the cost of the Project in the same ratio as the share of respective development in the Property (i.e. Villas- 50% and other developments (group housing etc.) – 36.33%). The cost of the Project shall include:
>
> a. Land cost b. License and approval costs c. Construction cost d. Direct project management costs (people at the site) e. Marketing & sales promotion cost f. Liaison cost g. Maintenance cost for unsold inventory PART H h. Government levies and charges including EDS & IDC and any enhancement thereof." It appears that the parties converted the Development Agreement into an Agreement to Sell executed along with a Side Letter to circumvent the legal prohibition on splitting a development license in two parts. The transaction between AAA and the Corporate Debtor was collusive in nature.
>
> 52 Since the commercial arrangements between Spade and AAA, and the Corporate Debtor were collusive in nature, they would not constitute a 'financial debt'. Hence, Spade and AAA are not financial creditors of the Corporate Debtor.

H Whether Spade and AAA are related parties

53 The Appellate Tribunal has affirmed the decision of the NCLT to exclude

> Spade and AAA from the CoC on the ground that they are related parties. As we have seen earlier, there was a specific finding in the decision of the NCLT on the close business relationship between AAA and Spade on one hand and the Corporate Debtor on the other, in terms of the provisions contained in Section 5(24). The decision of the NCLT spoke of a deep entanglement in the business affairs. The NCLT came to the specific finding that Spade and AAA "were related parties" of the corporate debtor but, that the relationship had ended by the time the initiation of the CIRP took place. It is this aspect which now merits consideration. We shall first analyse whether Spade and AAA are related parties of the Corporate Debtor.

PART H H.1 Submissions of Counsel 54 Assailing the judgment of the NCLAT, Mr Viswanathan submits:

> (i) There were no common key managerial personnel or directors between the Corporate Debtor and Spade and AAA during the relevant period of the transactions

between 2010 to 2013;

(ii) The Appellate Tribunal has incorrectly held that Mr Arun Anand was in a position to influence the decision making of the Corporate Debtor, without satisfying the test of "control" established in Arcelor Mittal India (P) Ltd.

vs Satish Kumar Gupta15;

(iii) Mr Arun Anand was a mere salaried employee without any ability to influence the decision-making process. He did not attend any Board Meetings, and did not give any directions to the directors or individuals in the Corporate Debtor;

(iv) Mr Arun Anand was Group CEO of Anil Anand Group of Companies for only 81 days, which was also a titular position and not a statutory position since there was no approval from the Board of Directors. Hence, he could not have influenced any policy making process of the Corporate Debtor in accordance with Section 5(24)(m)(i);

(v) JIPL, and through it the Corporate Debtor, holds only 1.45% shareholding in Spade, which is below the 2% threshold in Section 5(24)(d); (2019) 2 SCC 1 PART H

(vi) The Corporate Debtor and AAA are incorrectly assumed to be 'partners' in accordance with Section 5(24)(a);

(vii) The two transactions mentioned in order to prove a relationship under Section 5(24)(f) were commercial transactions where the Corporate Debtor borrowed money from Spade to pay third parties, which would have been paid back with interest; and

(viii) Section 5(24A) has no application, since it applies to the insolvency resolution and liquidation process for individuals and partnerships. 55 Supporting the judgment of the NCLAT, Mr Kaul submits:

(i) Mr Arun Anand incorporated the Corporate Debtor on 15 December 2003, following which it was acquired by Mr Anil Nanda in 2007. Mr Arun Anand has also held numerous positions in the Anil Nanda Group of Companies, and has a long-standing relationship with Mr Anil Nanda;

(ii) During the relevant transactions with Spade and AAA, Mr Arun Anand held the position of Consultant or Strategic Advisor to the Corporate Debtor, and later became the Group CEO of the Anil Nanda Group of Companies (of which the Corporate Debtor is also a part);

(iii) During this period, Mr Arun Anand's brother in-law, Mr Sonal Anand, was a director and COO of the Corporate Debtor. Further, he was also the Whole Time Director of JIPL, which is a wholly-owned subsidiary of the Corporate Debtor, and

holds shareholding in Spade;

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(iv) During this period, Mr Anil Nanda was the promoter/director of the Corporate Debtor; and

(v) The ongoing litigation between Spade and the Corporate Debtor was only started after the IBC came into force, to create a notion of dispute. 56 The submissions of Mr Kaul are supported by Mr Sen. He submits:

(i) Two of the original shareholders of the Corporate Debtor, along with Mr Arun Anand, now have shareholding and positions in Spade; and

(ii) There have been fraudulent transactions between Spade and JIPL, in which JIPL paid a sum to Spade for transfer of shares, which never occurred. This is a subject of proceedings under Section 66 of the IBC initiated by the RP.

H.2 Statutory provisions

57 The definition of the expression ‘related party’ in Section 5(24) is

exhaustive, since the expression is defined to “mean” what is set out in clauses

(a) to (m). The expression ‘related party’ is defined in Section 5 (24) as follows:

“(24) "related party", in relation to a corporate debtor, means—

(a) a director or partner of the corporate debtor or a relative of a director or partner of the corporate debtor;

(b) a key managerial personnel of the corporate debtor or a relative of a key managerial personnel of the corporate debtor;

(c) a limited liability partnership or a partnership firm in which a director, partner, or manager of the corporate debtor or his relative is a partner;

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(d) a private company in which a director, partner or manager of the corporate debtor is a director and holds along with his relatives, more than two per cent. of its share capital;

(e) a public company in which a director, partner or manager of the corporate debtor is a director and holds along with relatives, more than two per cent. of its paid-up share capital;

(f) anybody corporate whose board of directors, managing director or manager, in the ordinary course of business, acts on the advice, directions or instructions of a director, partner or manager of the corporate debtor;

(g) any limited liability partnership or a partnership firm whose partners or employees in the ordinary course of business, acts on the advice, directions or instructions of a director, partner or manager of the corporate debtor;

(h) any person on whose advice, directions or instructions, a director, partner or manager of the corporate debtor is accustomed to act;

(i) a body corporate which is a holding, subsidiary or an associate company of the corporate debtor, or a subsidiary of a holding company to which the corporate debtor is a subsidiary;

(j) any person who controls more than twenty per cent. of voting rights in the corporate debtor on account of ownership or a voting agreement;

(k) any person in whom the corporate debtor controls more than twenty per cent. of voting rights on account of ownership or a voting agreement;

(l) any person who can control the composition of the board of directors or corresponding governing body of the corporate debtor;

(m) any person who is associated with the corporate debtor on account of—

(i) participation in policy making processes of the corporate debtor; or

(ii) having more than two directors in common between the corporate debtor and such person; or (iii) interchange of managerial personnel between the corporate debtor and such person; or

(iv) provision of essential technical information to, or from, the corporate debtor;" PART H The expression 'related party' is defined in Section 5(24) in relation to a corporate debtor. Section 5(24A) provides a corresponding definition in relation to an individual.

58 The definition describes a commutative relationship, meaning that X can be a related party of Y, if either X is related to Y, or Y is related to X. The definition of 'related party' under the IBC is significantly broad. The intention of the legislature in adopting such a broad definition was to capture all kinds of inter- relationships between the financial creditor and the corporate debtor16. 59 The term 'related party' has also been defined by Parliament in the Companies Act, 2013 for all corporations. The definition of the expression has also been expanded for listed entities by the Securities Exchange Board of India by amendment to the Equity Listing Agreement to include elements mentioned under applicable accounting standards. However, in the present case, we are assessing its definition only under the IBC, which is exhaustive. The purpose of defining the term separately under different statutes is not to avoid inconsistency but because the purpose of each of

them is different. Hence, while understanding the meaning of 'related party' in the context of the IBC, it is important to keep in mind that it was defined to ensure that those entities which are related to the Corporate Debtor can be identified clearly, since their presence can often negatively affect the insolvency process.

Richa Saraf, 'Concept of Related Party: Interpretation by Letter or Spirit of the IBC?', (IndiaCorpLaw, 11 August 2018) available at <https://indiacorplaw.in/2018/08/concept-related-party-interpretation-letter-spirit- ibc.html>.

PART H H.3 Analysis 60 Crucial to the understanding of whether Spade and AAA were related parties of the Corporate Debtor during the relevant period is the relationship between Mr Arun Anand and Mr Anil Nanda. It is Mr Viswanathan's argument that these individuals shared no prior relationship, which has been opposed by Mr Kaul and Mr Sen. We noted that Mr Arun Anand has held multiple positions in companies which form part of Anil Nanda Group of Companies. Further, Mr Anil Nanda has himself invested in companies owned by Mr Arun Anand, and had commercial transactions with them. Through Spade and AAA's own admission, Mr Arun Anand was appointed as the Group CEO of the Anil Nanda Group of Companies (for however short a period) on circular approval by Mr Anil Nanda himself. Finally, Mr Arun Anand's brother in-law, Mr Sonal Anand, has also been consistently associated with companies in the Anil Nanda Group of Companies, including the Corporate Debtor and JIPL. This deep entanglement between these individuals was noted by the NCLT and the NCLAT.

61 Admittedly, Mr Arun Anand was in control of Spade and AAA during the relevant period. Further, he held positions in the Corporate Debtor or the Anil Nanda Group of Companies, which included the Corporate Debtor. Mr Anil Nanda and Mr Sonal Anand also held positions in the Corporate Debtor and JIPL during this period.

62 Based on the above, it is not difficult for us to accept the conclusion of the NCLAT that Mr Arun Anand would be a related party of the Corporate Debtor in accordance with Section 5(24)(h) and Sections 5(24)(m)(i). Mr Viswanathan has PART H tried to refute this argument by relying on the definition of 'control' in Arcelor Mittal India (P) Ltd. vs Satish Kumar Gupta (supra). However, it is important to note that the discussion there was in the context of ineligible resolution applicants under Sub-section (c) of Section 29-A of the IBC, which specifically prescribes this test. Presently, we have to determine whether the Corporate Debtor's board, directors, etc, are accustomed to act on Mr Arun Anand's advice/direction/instruction and if he participates in the policy-making process of the Corporate Debtor. While a strict determination of intent or mens rea may not always be possible by the NCLT and NCLAT in summary proceedings, it is possible to draw the inference from the facts at hand. These facts are that there was a deep entanglement between the entities of Mr Arun Anand and Mr Anil Nanda, and Mr Arun Anand did hold positions during this period which could have been used by him to guide the affairs of the Corporate Debtor. This finding is further supported by our conclusion that the transactions between the Corporate Debtor and the entities led by Mr Arun Anand were collusive in nature. 63 Similarly, we have no hesitation in accepting the NCLAT's conclusion that Spade entered into two transactions on the basis of the advice/instructions/directions of the board/directors of the Corporate Debtor under Section

5(24)(f). Mr Viswanathan's submission that these were purely commercial transactions between the parties cannot be accepted, given the extensive history demonstrating the interrelationship between the individuals associated with these corporations. While the transactions may have indeed been commercial, it cannot be doubted that Spade undertook them due to the pervasive influence of Mr Anil Nanda. In our analysis above, we have similarly PART H come to the conclusion that other past transactions between these entities have been collusive.

64 Finally, we have already held that the transactions between AAA and the Corporate Debtor were collusive in nature. This supports the findings of the NCLAT that the Agreement to Sell and Side Letter dated 25 October 2012 were a mere eye-wash, through which they sought to develop the AKME RAAGA project together while circumventing government guidelines. Hence, AAA would be a partner of the Corporate Debtor within the meaning of Section 5(24)(a). 65 Therefore, we come to the conclusion that Mr Arun Anand, Spade and AAA were related parties of the Corporate Debtor during the relevant period when the transactions on the basis of which Spade and AAA claim their status as financial creditors took place.

PART I I Whether Spade and AAA can be excluded from the CoC 66 Section 21(1) of the IBC requires the IRP to form the CoC for the CIRP of the Corporate Debtor. The membership of the CoC is determined in accordance with Section 21(2), which reads thus:

> "(2) The committee of creditors shall comprise all financial creditors of the corporate debtor:
>
> Provided that a financial creditor or the authorised representative of the financial creditor referred to in sub- section (6) or sub-section (6-A) or sub-section (5) of Section 24, if it is a related party of the corporate debtor, shall not have any right of representation, participation or voting in a meeting of the committee of creditors:
>
> Provided further that the first proviso shall not apply to a financial creditor, regulated by a financial sector regulator, if it is a related party of the corporate debtor solely on account of conversion or substitution of debt into equity shares or instruments convertible into equity shares or completion of such transactions as may be prescribed, prior to the insolvency commencement date." Hence, the first proviso states that any financial creditor, barring the exceptions provided in the second proviso, shall not have any right of representation, participation and voting in the meeting of the CoC, if it is a related party of the Corporate Debtor.

67 The controversy in the present case is on the interpretation of the phrase "is" a related party in the first proviso, since the submission is that Spade and AAA are no longer related parties of the Corporate Debtor (even though in terms of the earlier finding they were so during the relevant period when the transactions constituting their alleged financial debt took place).

PART I

I.1 Submissions of Counsel

68 Mr Viswanathan sought to urge that the first proviso to Sub-section (2) of

Section 21 denies the right of representation, participation or voting in a meeting of the CoC to a financial creditor or an authorised representative of the financial creditor referred to inter alia in Sub-section (5) of Section 24, if it "is a related party of the corporate debtor". Laying stress on the expression 'is' a related party of the corporate debtor, the submission is that the statute applies in praesenti on the date of the admission of an application seeking the initiation of the CIRP. This submission is sought to be supported by urging that if the expression is a related party is not construed in its literal sense in praesenti, it will result in an ambiguity without a yardstick on how far back in point of time the relationship should be assessed. The use of that expression in the first proviso to Sub-section (2) of Section 24 has been contrasted with other provisions of the IBC. For instance, it has been submitted that in Section 29A, which elucidates when a person is not eligible to be a resolution applicant, there is a reference to both "is" and "has been". Clause (a) refers to a situation where a person "is an undischarged insolvent"; Clause (b) refers a person who "is a wilful defaulter"; Clause (d) adverts to a situation where a person "has been convicted"; and Clause (g) refers to a person who "has been a promoter". Hence, it is been submitted that clause 29A uses the expression "is" as distinct from "has been" in the application of various sub-clauses. Reference has been made to Section 43(4) which deals with preferential transactions and incorporates a look back period of two years. Reference has also been made in the course of the submission to Section 5(24)(m) which uses the expression "is associated" with the corporate debtor. PART I Based on the above submissions, it has been urged that where the statute intends to consider situations as they existed in the past, it has utilised expression "has been". Consequently, it has been urged that when in the first proviso to Section 21(2), the expression "is a related party" is used, this must clearly be a reference to the present and not to an uncertain past. In essence, it has been urged that the existence of a live link of being a related party in the present is a requirement of the statutory provision. 69 While opposing the submissions which have been urged by Mr Viswanathan, Mr Kaul, submitted that the provisions of Section 21(2) must receive a purposive interpretation. Mr Kaul has urged that if this were not done the provisions of the IBC will be defeated by adopting commercial artifices and contrivances. He urged that the interpretation which the court adopts must facilitate and not defeat the fulfilment of the objects of the legislation. We are inclined to agree with this submission for the reasons which we proceed to elaborate.

I.2 Related Parties and CoC Section 21(1) requires the IRP to constitute a CoC, after collating of the claims which are received against and determining the financial position of the corporate debtor. The CoC has to comprise of all financial creditors of the corporate debtor. The expression 'financial creditor' is defined in Section 5(7) to mean any person to whom a financial debt is owed and to include a person to whom such a debt has been legally assigned or transferred. The expression

'financial debt' is defined in Section 5(8). Under Section 28, the Resolution Professional is required PART I to take the prior approval of the CoC specifically on certain aspects. Section 28(1) provides as follows:

> "28. (1) Notwithstanding anything contained in any other law for the time being in force, the resolution professional, during the corporate insolvency resolution process, shall not take any of the following actions without the prior approval of the committee of creditors namely:—
>
> (a) raise any interim finance in excess of the amount as may be decided by the committee of creditors in their meeting;
>
> (b) create any security interest over the assets of the corporate debtor;
>
> (c) change the capital structure of the corporate debtor, including by way of issuance of additional securities, creating a new class of securities or buying back or redemption of issued securities in case the corporate debtor is a company;
>
> (d) record any change in the ownership interest of the corporate debtor;
>
> (e) give instructions to financial institutions maintaining accounts of the corporate debtor for a debit transaction from any such accounts in excess of the amount as may be decided by the committee of creditors in their meeting;
>
> (f) undertake any related party transaction;
>
> (g) amend any constitutional documents of the corporate debtor;
>
> (h) delegate its authority to any other person;
>
> (i) dispose of or permit the disposal of shares of any shareholder of the corporate debtor or their nominees to third parties;
>
> (j) make any change in the management of the corporate debtor or its subsidiary;
>
> (k) transfer rights or financial debts or operational debts under material contracts otherwise than in the ordinary course of business;
>
> (l) make changes in the appointment or terms of contract of such personnel as specified by the committee of creditors; or
>
> (m) make changes in the appointment or terms of contract of statutory auditors or internal auditors of the corporate debtor." PART I

70 In an instructive article published in the Yale Law Journal, titled 'Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain', Thomas H. Jackson, argues that creditors prefer a collective process as opposed to a race to grab as many assets, which often leads ultimately to the demise of the corporate debtor17. The reason why a collective process is considered superior is because individual creditors, left to their own whims, are motivated to act solely in their own interests, even when their interests may directly conflict with the creditors' collective interests as a group. This self-interest creates a collective action problem, such that creditors eventually enter a grab race, operating under the belief that they would have recourse to fewer or no assets, if they delay their actions in the hope that creditors will be able to coordinate and agree to act collectively18. Bankruptcy law seeks to resolve this by preventing individual creditor action. The creditor's bargain theory therefore, operates to maximise group welfare through collectivisation19.

71 In India, the IBC adopts a CIRP operationalised through the CoC once the CIRP commences20. In addition to the creditor's bargain theory, the design of the IBC is also influenced by the value-based theory postulated by Korobkin21, in an influential piece of academic writing in the Columbia Law review, whereunder insolvency law considers the distributional impact of winding up on those who may not have formal legal rights to the assets of the business. The aim of bankruptcy law under this theory is to take into account the multidimensional but Thomas H. Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain', 91 Yale Law Journal 857, (1982) at 859-71.

Supra at note 18, pgs 1855-1856.

Medha Shekar and Anuradha Guru, Theoretical Framework of Insolvency Law, available at <https://www.ibbi.gov.in/uploads/resources/9ce9ccf9f114750879b68c8a33235ca6.pdf>, at page 52. Douglas G. Baird, 'A World Without Bankruptcy', 50 Law & Contemporary Problems, Spring 1987, at 184. D.R. Korobkin, Rehabilitating values: A jurisprudence of bankruptcy, 91 Columbia Law Review (1991), at p.

717. PART I conflicting interests of various claimants, and provide for a solution whereunder each claimant derives optimal value22.

72 The CoC is comprised of financial creditors, under loan and debt contracts, who have the right to vote on decisions and operational creditors such as employees, rental obligations, utilities payments and trade credit, who can participate in the CoC, but do not have the right to vote. The aim of the CoC is to enable coordination between various creditors so as to ensure that the interests of all stakeholders are balanced, and the value of the assets of the entity in financial distress is maximised.

73 The report of the Bankruptcy Law Reforms Committee (Volume I:

> Rationale and Design) of November 2015, has underscored the need to meet the liabilities of all creditors, who are not part of the CIRP, and that of treating the rights of all creditors fairly, through the collective insolvency resolution process, operationalised by the CoC23. The report recognised this in the following terms:

> "[The] three core features that most well developed bankruptcy and insolvency resolution regimes share: a linear process that both creditors and debtors follow when insolvency is triggered; a collective mechanism for resolving insolvency within a framework of equity and fairness to all stakeholders to preserve economic value in the process; a time bound process either ends in keeping the firm as a going enterprise, or liquidates and distributes the assets to the various stakeholders. These features are common across widespread differences in structure and content, present either through statutory provisions or their implementation in practice ....
>
> These features ensure certainty in the process, starting from what constitutes insolvency, and the processes to be followed Supra at note 20.
>
> Bankruptcy Law Reforms Committee, Volume I: Rationale and Design, of November 2015, page 29.
>
> PART I to resolve the insolvency, or the process to resolve bankruptcy once it has been determined. Done correctly, such a framework can incentivise all stakeholders to behave rationally in negotiations towards determination of viability, or in bankruptcy resolution. In turn, this will lead to shorter times to recovery and better recovery under insolvency, and a greater certainty about creditors rights in developing a corporate debt market."

74 The long title of the IBC outlines the importance of a collective process aimed at value maximisation. The IBC has been enacted as:

> "An Act to consolidate and amend the laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximization of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders including alteration in the order of priority of payment of Government dues and to establish an Insolvency and Bankruptcy Board of India, and for matters connected therewith or incidental thereto."

75 These objects underscore the composition of the CoC, guided by Section 21 of the IBC. The objects and purposes of the Code are best served when the CIRP is driven by external creditors, so as ensure that the CoC is not sabotaged by related parties of the corporate debtor24. This is the intent behind the first proviso to Section 21(2) which disqualifies a financial creditor or the authorised representative of the financial creditor under sub-section (6) or sub-section (6A) or sub-section (5) of section 24, if it is a related party of the corporate debtor, from having any right of representation, participation or voting in a meeting of the committee of creditors.

Report of the Insolvency Law Committee, March 2018, p 23, para 1.25. PART I 76 Since the IBC attempts to balance the interests of all stakeholders, such that some stakeholders are not able to benefit at the expense of others, related party financial creditors are disqualified from being

represented, participating or voting in the CoC, so as to prevent them from controlling the CoC to unfairly benefit the corporate debtor25.

77 It is pertinent to note that disqualification of related parties from being members of the CoC, has also been recommended in the UNCITRAL Legislative Guide on Insolvency law26:

> "The insolvency law should specify the creditors that are eligible to be appointed to a committee. Creditors who may not be appointed to a creditor committee would include related persons and others who for any reason might not be impartial. The insolvency law should specify whether or not a creditor's claim must be admitted before the creditor is entitled to be appointed to a committee." In interpreting the legislation, which represents a Parliamentary effort to bring about structural changes in the resolution of corporate insolvencies, the effort of the court must be to aid the fulfilment of the objects of the IBC.

I.3 Amendment to First Proviso of Section 21(2)

78 Originally, the first proviso to Section 21(2) read as follows:

> "Provided that a related party to whom a corporate debtor owes a financial debt shall not have any right of representation, participation or voting in a meeting of the committee of creditors." Vidhi Centre for Legal Policy, Understanding the Insolvency and Bankruptcy Code, 2016: Analysing Developments in Jurisprudence, available at <https://vidhilegalpolicy.in/research/understanding-the-insolvency-and-bankruptcy-code-2016-analysing-developments-in-jurisprudence/>, at page 34.
>
> UNCITRAL, Legislative Guide on Insolvency Law, 2005, available at <https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/05-80722_ebook.pdf>, at page
>
> 204.

PART I 79 The language was subsequently amended by the Amendment Act, 2018 and at present the first proviso reads as follows:

> "Provided that a financial creditor or the authorised representative of the financial creditor referred to in sub- section (6) or sub-section (6A) or sub-section (5) of section 24, if it is a related party of the corporate debtor, shall not have any right of representation, participation or voting in a meeting of the committee of creditors."

80 The reason for the amendment appears to be the need to extend the disqualification in the first proviso of Section 21(2) to authorised representatives of financial creditors mentioned in Sections 21(6), 21(6A) and Section 24(5) as well. This was recommended by the Insolvency Law Committee,

in its Report of March 2018, where it was observed:

> "10. 6 For certain securities, a trustee or an agent may already be appointed as per the terms of the security instrument. For example, a debenture trustee would be appointed if debentures exceeding 500 have been issued or if secured debentures are issued. Such creditors may be represented through such pre-appointed trustees or agents. For other classes of creditors which exceed a certain threshold in number, like home buyers or security holders for whom no trustee or agent has already been appointed under a debt instrument or otherwise, an insolvency professional (other than the IRP) shall be appointed by the NCLT on the request of the IRP. It is to be noted that as the agent or trustee or insolvency professional, i.e., the authorised representative for the creditors discussed above and executors, guarantors, etc. as discussed in paragraph 9 of this Report, shall be a part of the CoC, they cannot be related parties to the corporate debtor in line with the spirit of proviso to section 21(2).
>
> 10.7 Section 71(6) of the CA 2013 obliges the debenture trustee to take steps to protect the interests of the debenture holders and redress their grievances. The provisions regarding meetings of the debenture trustee and debenture holders is as per the trust deed. The Companies (Acceptance of Deposit) Rules, 2014 ("Deposit Rules") provide that the deposit trustee may call a meeting of the deposit holders as PART I and when required and provides specific power to call a meeting on the happening of any event of default. Though broad powers are already given to trustees, the respective rules for debentures and deposits under CA 2013 may need to be modified corresponding to the amendments in the Code and CIRP Rules / CIRP Regulations to provide clarity on empowering debenture trustees to file for initiation of CIRP on behalf of the creditors and vote on their behalf.
>
> 10.8 In light of the deliberation above, the Committee felt that a mechanism requires to be provided in the Code to mandate representation in meetings of security holders, deposit holders, and all other classes of financial creditors which exceed a certain number, through an authorised representative. This can be done by adding a new provision to section 21 of the Code. Such a representative may either be a trustee or an agent appointed under the terms of the debt agreement of such creditors, otherwise an insolvency professional may be appointed by the NCLT for each such class of financial creditors. Additionally, the representative shall act and attend the meetings on behalf of the respective class of financial creditors and shall vote on behalf of each of the financial creditor to the extent of the voting share of each such creditor, and as per their instructions. To ensure adequate representation by the authorised representative of the financial creditors, a specific provision laying down the rights and duties of such authorised representatives may be inserted. Further, the requisite threshold for the number of creditors and manner of voting may be specified by IBBI through regulations to enable efficient voting by the representative. Also, regulation 25 may also be amended to enable voting through electronic means

> such as e-mail, to address any technical issues which may arise due to a large number of creditors voting at the same time." (emphasis supplied)

81 Consequently, the first proviso to Section 21(2) was amended, to extend the disqualification to the specified authorised representatives, in case that these representatives happened to be related parties of the corporate debtor. The introduction of the phrase "is" along with related party was not a guiding factor behind the Parliamentary amendment.

PART I I.4 Related Parties - Interpretation In Praesenti 82 An issue of interpretation in relation to the first proviso of Section 21(2) is whether the disqualification under the proviso would attach to a financial creditor only in praesenti, or if the disqualification also extends to those financial creditors who were related to the corporate debtor at the time of acquiring the debt. 83 In Arcelor Mittal India Private Limited vs. Satish Kumar Gupta (supra), the issue was whether ineligibility of the resolution applicant under Section 29- A(c) of the Code attached to an applicant at the date of commencement of the CIRP or at the time when the resolution plan is submitted by the resolution applicant. Speaking for this Court, Justice Rohinton F Nariman interpreted the pre-2018 amendment, framing of Section 29-A(c), in the following terms:

> "46. According to us, it is clear that the opening words of Section 29-A furnish a clue as to the time at which clause (c) is to operate. The opening words of Section 29-A state: "a person shall not be eligible to submit a resolution plan…". It is clear therefore that the stage of ineligibility attaches when the resolution plan is submitted by a resolution applicant. The contrary view expressed by Shri Rohatgi is obviously incorrect, as the date of commencement of the corporate insolvency resolution process is only relevant for the purpose of calculating whether one year has lapsed from the date of classification of a person as a non-performing asset. Further, the expression used is "has", which as Dr Singhvi has correctly argued, is in praesenti. This is to be contrasted with the expression "has been", which is used in clauses (d) and
>
> (g), which refers to an anterior point of time. Consequently, the amendment of 2018 introducing the words "at the time of submission of the resolution plan" is clarificatory, as this was always the correct interpretation as to the point of time at which the disqualification in clause (c) of Section 29-A will attach." PART I

84 Thus, facially, it would appear that the use of the simple present tense in the first proviso to Section 21(2) indicates that the disqualification applies in praesenti. Furthermore, this interpretation would also be supported by a reading of the first proviso to Section 21(2), in light of the definition of 'related party' under Section 5(24), which uses phrases such as 'is accustomed to act' or 'is associated' to define a related party in the present tense. 85 However, it is relevant to examine whether the object and purpose for which the proviso was enacted, are fulfilled by the literal interpretation of the first proviso. Justice G.P. Singh in his authoritative commentary on the interpretation of statutes, Principles of Statutory Interpretation27, has stated that:

"The intention of the Legislature thus assimilates two aspects: In one aspect it carries the concept of 'meaning', i.e., what the words mean and in another aspect, it conveys the concept of 'purpose and object' or the 'reason and spirit' pervading through the statute. The process of construction, therefore, combines both literal and purposive approaches. In other words the legislative intention, i.e., the true or legal meaning of an enactment is derived by considering the meaning of the words used in the enactment in the light of any discernible purpose or object which comprehends the mischief and its remedy to which the enactment is directed. This formulation later received the approval of the Supreme Court and was called the "cardinal principle of construction"." He notes that certain enactments require a liberal construction to give effect to its objects and purpose:

"A bare mechanical interpretation of the words and application of a legislative intent devoid of concept of purpose will reduce most of the remedial and beneficent legislation to futility. As stated by Iyer, J. "to be literal in meaning is to see the skin and miss the soul. The judicial key to construction is the composite perception of the deha and the dehi of the 27 st G.P. Singh, Principles of Statutory Interpretation (1 edn., Lexis Nexis 2015) PART I provision." Even in construing enactments such as those prescribing a period of limitation for initiation of proceedings where the purpose is only to intimate the people that after lapse of a certain time from a certain event a proceeding will not be entertained and where a strict grammatical construction is normally the only safe guide, a literal and mechanical construction may have to be disregarded if it conflicts with some essential requirement of fair play and natural justice which the Legislature never intended to throw overboard. Similarly, in a taxing statute provisions enacted to prevent tax evasion are given a liberal construction to effectuate the purpose of suppressing tax evasion although provisions imposing a charge are construed strictly there being no a priori liability to pay a tax and the purpose of a charging section being only to levy a charge on persons and activities brought within its clear terms. For the same reason, in a legislation relating to defence services "the considerations of the security of the state and enforcement of high degree of discipline additionally intervene and have to be assigned weightage while dealing with any expression needing to be defined or any provision needing to be interpreted." Similar words used in different parts of the enactment can have different meanings. As Justice G P Singh notes:

"The rule is of general application as even plainest terms may be controlled by the context, and "it is conceivable," as Lord Watson said, "that the Legislature whilst enacting one clause in plain terms, might introduce into the same statute other enactments which to some extent qualify or neutralise its effect". The same word may mean one thing in one context and another in a different context. For this reason the same word used in different sections of a statute or even when used at different places in the same clause or section of a statute may bear different meanings. The conclusion that the language used by the Legislature is plain or ambiguous can only be truly arrived at by studying the statute as a whole. How far and to what extent

each component part of the statute influences the meaning of the other part would be different in each given case. But the effect of the application of the rule to a particular case, should not be confounded with the legitimacy of applying it. ” (emphasis added) PART I

86 In this context, it would be useful to refer to an earlier decision of this Court in Abhay Singh Chautala vs C.B.I.28, where the court did not interpret the word “is” in praesenti because that would lead to an absurd result, defeating the purpose of the concerned provision. In that case this Court had to interpret Section 19(1) of the Prevention of Corruption Act, 1947, which provided:

“19. Previous sanction necessary for prosecution.

(1) No court shall take cognizance of an offence punishable under Sections 7, 10, 11, 13 and 15 alleged to have been committed by a public servant, except with the previous sanction, -

(a) In the case of a person who is employed in connection with the affairs of the Union and is not removable from his office save by or with the sanction of the Central Government, of that Government;

(b) In the case of a person who is employed in connection with the affairs of a State and is not removable from his office save by or with the sanction of the State Government, of that Government;

(c) In the case of any other person, of the authority competent to remove him from his office.” (emphasis supplied)

87 It was argued before this Court that a literal interpretation should be given to Section 19(1). Since the word “is” has been used in sub-sections (a), (b) and

(c), it was urged that this would exclude a public servant who had abused office at an earlier point in time and has now ceased to occupy that office. This Court speaking through Justice Sirpurkar rejected the argument and held:

“44...we reject the argument based on the word "is" in Sub- sections (a), (b) and (c). It is true that the Section operates in praesenti; however, the Section contemplates a person who continues to be a public servant on the date of taking (2011) 7 SCC 141 PART I cognizance. However, as per the interpretation, it excludes a person who has abused some other office than the one which he is holding on the date of taking cognizance, by necessary implication. Once that is clear, the necessity of the literal interpretation would not be there in the present case.

Therefore, while we agree with the principles laid down in Robert Wigram Crawford v. Richard Spooner 4 MIA 179, Re Bedia v. Genreal Accident, Fir and Life Assurance Corporation Ltd. 1948 (2)

All ER 995 and Bourne (Inspector of Taxes) v. Norwich Crematorium Ltd.1967 (2) All ER 576, we specifically hold that giving the literal interpretation to the Section would lead to absurdity and some unwanted results, as had already been pointed out in Antulay's case (cited supra) (see the emphasis supplied to para 24 of Antulay's judgment).” 88 This Court relied on the judgement in R S Nayak v. A R Antulay to fortify its interpretation of Section 19(1) of the Prevention of Corruption Act, 1947:

> “24 .... An illustration was posed to the learned Counsel that a Minister who is indisputably a public servant greased his palms by abusing his office as Minister, and then ceased to hold the office before the court was called upon to take cognizance of the offence against him and therefore, sanction as contemplated by Section 6 would not be necessary; but if after committing the offence and before the date of taking of cognizance of the offence, he was elected as a Municipal President in which capacity he was a public servant under the relevant Municipal law, and was holding that office on the date on which court proceeded to take cognizance of the offence committed by him as a Minister, would a sanction be necessary and that too of that authority competent to remove him from the office of the Municipal President. The answer was- in affirmative. But the very illustration would show that such cannot be the law. Such an interpretation of Section 6 would render it as a shield to an unscrupulous public servant. Someone interested in protecting may shift him from one office of public servant to another and thereby defeat the process of law. One can legitimately envisage a situation wherein a person may hold a dozen different offices, each one clothing him with the status of a public servant under Section 21 IPC and even if he has abused only one office for which either there is a valid sanction to prosecute him or he has ceased to hold that office by the time court was called upon to take cognizance, yet on this assumption, sanction of 11 different competent authorities each of which was entitled to remove him from 11 different public offices PART I would be necessary before the court can take cognizance of the offence committed by such public servant/while abusing one office which he may have ceased to hold. Such an interpretation in contrary to all canons of construction and leads to an absurd and product which of necessity must be avoided. Legislation must at all costs be interpreted in such a way that it would not operate as a rougue's charter.” (emphasis supplied)

89 This court has approved of a purposive interpretation of Section 29-A of the IBC in Arcelor Mittal India Private Limited v. Satish Kumar Gupta (supra), where it was observed that:

> “29...In Ms. Eera Through Dr. Manjula Krippendorf v. State (Govt. of NCT of Delhi) and Anr., (2017) 15 SCC 133, this Court, after referring to the golden Rule of literal construction, and its older counterpart the "object rule" in Heydon's case, referred to the theory of creative interpretation as follows:
>
> 122. Instances of creative interpretation are when the Court looks at both the literal language as well as the purpose or object of the statute in order to better determine

> what the words used by the draftsman of legislation mean. In D.R. Venkatachalam v. Transport Commr. [D.R. Venkatachalam v.

Transport Commr., (1977) 2 SCC 273, an early instance of this is found in the concurring judgment of Beg, J. The learned Judge put it rather well when he said: (SCC p. 287, para 28):

> "28. It is, however, becoming increasingly fashionable to start with some theory of what is basic to a provision or a chapter or in a statute or even to our Constitution in order to interpret and determine the meaning of a particular provision or Rule made to subserve an assumed "basic" requirement. I think that this novel method of construction puts, if I may say so, the cart before the horse. It is apt to seriously mislead us unless the tendency to use such a mode of construction is checked or corrected by this Court. What is basic for a Section or a chapter in a statute is provided: firstly, by the words used in the statute itself; secondly, by the context in which a provision occurs, or, in other words, by reading the statute as a whole; thirdly, by the Preamble which could supply the "key" to the meaning of the statute in cases of uncertainty or doubt; and, fourthly, where some further aid to PART I construction may still be needed to resolve an uncertainty, by the legislative history which discloses the wider context or perspective in which a provision was made to meet a particular need or to satisfy a particular purpose. The last mentioned method consists of an application of the mischief Rule laid down in Heydon case [Heydon case, (1584) 3 Co Rep 7a: 76 ER 637] long ago." ....
>
> 127. It is thus clear on a reading of English, US, Australian and our own Supreme Court judgments that the "Lakshman Rekha" has in fact been extended to move away from the strictly literal Rule of interpretation back to the Rule of the old English case of Heydon [Heydon case, (1584) 3 Co Rep 7a: 76 ER 637], where the Court must have recourse to the purpose, object, text and context of a particular provision before arriving at a judicial result. In fact, the wheel has turned full circle. It started out by the Rule as stated in 1584 in Heydon case [Heydon case, (1584) 3 Co Rep 7a : 76 ER 637], which was then waylaid by the literal interpretation Rule laid down by the Privy Council and the House of Lords in the mid-1800s, and has come back to restate the Rule somewhat in terms of what was most felicitously put over 400 years ago in Heydon case [Heydon case, (1584) 3 Co Rep 7a : 76 ER 637].
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> 30. A purposive interpretation of Section 29A, depending both on the text and the context in which the provision was enacted, must, therefore, inform our interpretation of the same." (emphasis supplied)

90 Hence, we would need to consider the meaning of the first proviso in the light of the context, object and purpose for which it was enacted. The purpose of excluding a related party of a corporate debtor from the CoC is to obviate conflicts of interest which are likely to arise in the event that a related party is allowed to become a part of the CoC. The logic underlying the exclusion has been summarised as follows29:

Insolvency Law Committee Report, 2020, pp 47-48, para 11.9.

PART I "The Committee was of the view that the disability under the first proviso to Section 21(2) is aimed at removing any conflict of interest within the CoC, to prevent erstwhile promoters and other related parties of the corporate debtor from gaining control of the corporate debtor during the CIRP by virtue of any loan that may have been provided by them." Accepting the submission of Mr Viswanathan would allow the statutory provision to be defeated by a related party of a corporate debtor creating commercial contrivances which have the effect of denuding its status as a related party, by the time that the CIRP is initiated. The true test for determining whether the exclusion in the first proviso to Section 21(2) applies must be formulated in a manner which would advance the object and purpose of the statute and not lead to its provisions being defeated by disingenuous strategies.

91 Therefore, it could be stated that where a financial creditor seeks a position on the CoC on the basis of a debt which was created when it was a related party of the corporate debtor, the exclusion which is created by the first proviso to Section 21(2) must apply. For, it is on the strength of the financial debt as defined in Section 5(8) that an entity claiming as a financial creditor under Section 5(7) seeks a position on the CoC under Section 21(2). If the definition of the expression 'related party' under section 5(24) applies at the time when the debt was created, the exclusion in the first proviso to Section 21(2) would stand attracted.

92 However, if such an interpretation is given to the first proviso of Section 21(2), all financial creditors would stand excluded if they were a 'related party' of the corporate debtor at the time when the financial debt was created. This may arguably lead to absurd conclusions for entities which have legitimately taken PART I over the debt of related parties, or where the related party entity had stopped being a 'related party' long ago.

93 In this regard, it is relevant to note the observations in the Insolvency Law Committee Report of 2020 clarifying the eligibility of third-party assignees of the debt of a related party creditor, to be members of the CoC. It was observed:

"11.09 ... As a third-party assignee, who by itself is not a related party, would not have any such conflict of interest, it should not be disabled from participating in the CoC. Further, the aforesaid disability is not related to the debt itself but is based on the relationship existing between a related party creditor and the corporate debtor. Therefore, as the disability imposed under the first proviso to Section 21(2) pertains to the related party financial creditor and not to the debt it is owed, the Committee agreed that it is clear that when a related party financial creditor assigns her debt to a third party in good faith, such third party should not be disqualified from participating, voting or being represented in a meeting of the CoC.

11.10. However, the Committee discussed that in certain cases, a related party creditor may assign its debts with the intention of circumventing the disability

> imposed under the first proviso to Section 21(2) by indirectly participating in the CoC through the assignee. As a related party is expressly prohibited from participating in the CoC, it cannot do so indirectly by assigning its debt to a third-party assignee for the purposes of circumventing this restriction. Therefore, in order to prevent any misuse, the Committee recommended that prior to including an assignee of a related party financial creditor within the CoC, the resolution professional should verify that the assignee is not a related party of the corporate debtor. In cases where it may be proved that a related party financial creditor had assigned or transferred its debts to a third party in bad faith or with a fraudulent intent to vitiate the proceedings under the Code, the assignee should be treated akin to a related party financial creditor under the first proviso to Section 21(2)." (emphasis supplied) PART I

94 Thus, it has been clarified that the exclusion under the first proviso to Section 21(2) is related not to the debt itself but to the relationship existing between a related party financial creditor and the corporate debtor. As such, the financial creditor who in praesenti is not a related party, would not be debarred from being a member of the CoC. However, in case where the related party financial creditor divests itself of its shareholding or ceases to become a related party in a business capacity with the sole intention of participating the CoC and sabotage the CIRP, by diluting the vote share of other creditors or otherwise, it would be in keeping with the object and purpose of the first proviso to Section 21(2), to consider the former related party creditor, as one debarred under the first proviso.

95 Hence, while the default rule under the first proviso to Section 21(2) is that only those financial creditors that are related parties in praesenti would be debarred from the CoC, those related party financial creditors that cease to be related parties in order to circumvent the exclusion under the first proviso to Section 21(2), should also be considered as being covered by the exclusion thereunder. Mr Kaul has argued, correctly in our opinion, that if this interpretation is not given to the first proviso of Section 21(2), then a related party financial creditor can devise a mechanism to remove its label of a 'related party' before the Corporate Debtor undergoes CIRP, so as to be able to enter the CoC and influence its decision making at the cost of other financial creditors. 96 In the present case, there is a finding that AAA and Spade were related parties within the meaning of Section 5(24) at the time when the alleged financial debt on the basis of which they assert a claim to be a part of the CoC was PART J created. This was due to the long-standing relationship between Mr Arun Anand and Mr Anil Nanda, and their respective corporations. Admittedly, such a relationship still existed even in 2017, since Mr Anil Nanda's JIPL held shareholding in Mr Arun Anand's Spade. Further, we have also concluded that the transactions between Spade and AAA on one hand, and the Corporate Debtor on the other hand, which gave rise to their alleged financial debts were collusive in nature. Therefore, it is evident that there existed a deeply entangled relationship between Spade, AAA and Corporate Debtor, when the alleged financial debt arose. While their status as related parties may no longer stand, we are inclined to agree with Mr Kaul that this was due to commercial contrivances through which these entities seek to now enter the CoC. The pervasive influence of Mr Anil Nanda (the promoter/director of the Corporate Debtor) over these entities is clear, and allowing them in the CoC would definitely affect the other independent financial creditors.

J Conclusion

97 In conclusion, we hold that:

(i) The decision of the NCLAT, in as much as it referred to Spade and AAA as financial creditors, is set aside. Due to the collusive nature of their transactions alleged to be a financial debt under Section 5(8), Spade and AAA cannot be labelled as financial creditors under Section 5(7);

(ii) The decision of the NCLAT, in as much as it referred to Spade and AAA as related parties of the Corporate Debtor under Section 5(24), is affirmed; and PART J

(iii) The decision of the NCLAT, in as much as it excluded Spade and AAA from the CoC in accordance with the first proviso of Section 21(2), is affirmed but for the reasons mentioned above.

98 The appeals are accordingly disposed of.

99 Pending application(s), if any, stand disposed of.

……..……..J. [Dr Dhananjaya Y Chandrachud]
……..J. [Indu Malhotra]
.....J. [Indira Banerjee] New Delhi;

February 01, 2021.