

Triggering Limitation for Filing a Winding-Up Petition vis-à-vis Commercial Insolvency

written by Gaurav Singh Gaur | October 22, 2019

The Hon'ble Supreme Court in its recent judgment in

Jignesh

Shah and another v. Union of India and another^[1]

held that though the winding-up proceeding is a proceeding '*in rem*', not a recovery proceeding, the date of default alone is relevant for the purpose of triggering limitation for filing of a winding-up petition against a Company.

FACTS - Winding-Up Petition

Brief

facts necessary to appreciate complexities pertaining to the present case are as hereunder:

1. A winding-up petition was initiated by IL&FS Financial Services Limited (hereinafter referred as "IL&FS") against La-Fin Financial Services Private Limited (hereinafter referred as "La-Fin") on 21-10-2016, in the Bombay High Court under Section 433(e) of the Companies Act, 1956;
2. On 01-12-2016, the Insolvency and Bankruptcy Code, 2016 ("Code") came into force and consequently as per the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016 the winding-up petition was transferred to NCLT as Section 7 application under the Code;
3. The petition pertains to an alleged default by La-Fin to comply with its undertaking to buy back 442 lakhs shares of MCX Stock Exchange Limited (hereinafter referred to as "MCX-SX") which is a group company of La-Fin. The NCLT, admitting the winding-up petition vide its order dated 28-08-2018, stated that
a on mere perusal and reading of the share purchase agreement and the Letter of Undertaking it was clear that a financial debt had, in fact, been incurred by La-Fin;
4. The NCLAT by its order dated 21-01-2019 dismissed the appeal filed by Mr. Jignesh Shah (shareholder of La-Fin) against the order of admission, wherein NCLAT affirmed the observation of NCLT that the aforesaid transaction would fall within the meaning of "financial debt" under the Code, and that the
bar of limitation would not be attracted as the winding-up petition was filed within three years of the date from which the Code came into force i.e. on 01-12-2016;
5. A Writ Petition was also filed by Smt. Pushpa Shah (shareholder of La-Fin), challenging certain provisions of the Code. Another Writ Petition was also filed before the Hon'ble Supreme Court on 04-04-2019 challenging the constitutionality of certain provisions as well as the NCLT and NCLAT orders after which another Civil Appeal was also filed against the NCLAT order under Section 62 of the Code.

ISSUES - Winding-Up Petition

The Hon'ble Bench comprising of Hon'ble R.F. Nariman

J., R. Subhash Reddy J. and Surya Kant J. considered the following Question of

Law and Fact:

- In light of Article 137 of the Limitation Act, whether the winding-up petition initiated by IL&FS against La-Fin on 21-10-2016, was time-barred and could it be proceeded with any further?

SUBMISSIONS

The learned Senior Advocate, Dr. Abhishek Manu Singhvi, appearing on behalf of the Mr. Jignesh Shah & anr. ("Appellants") without going into the merits of the case had raised the statutory bar of limitation against IL & FS. The learned Senior Advocate placed his reliance on the judgment in *B.K. Educational Services Pvt. Ltd. v. Parag Gupta and Associates*^[2].

According to him, it is clear from the judgment that the Limitation Act, 1963 would apply to all Section 7 applications that are filed under IBC and that the

residuary Article 137 of the Limitation Act would be attracted to the facts of

this case.

Furthermore, inasmuch as the winding-up petition that has been transferred to the NCLT was filed on 21-10-2016, i.e. beyond the

period of 3 years prescribed (as the cause of action had arisen in August, 2012), it is clear that a time-barred winding-up petition filed under Section 433 of the Companies Act, 1956 would not suddenly get resuscitated into a Section 7 petition under the Code filed within time, by virtue of the transfer

of such petition. He further emphasised on Form -1 filed by IL & FS to transfer the winding-up petition to NCLT, that the Form itself stated that the

date of default was 19-08-2012 which clearly indicates that winding-up petition

was time-barred since it was filed beyond three years of the cause of action.

To counter the same, Shri Neeraj Kishan Kaul, the learned Senior Advocate appearing on behalf of the IL & FS ("Respondent") argued that the cause of action for the suit and the cause of action for the winding-up

petition filed, were separate and distinct. He further submitted that it is a well-settled principle that a winding-up petition cannot be filed in order to recover a debt, but is a proceeding 'in rem', which involves commercial insolvency of the company sought to be wound up.

According to the learned Advocate for Respondents, the suit that was filed by IL&FS for specific performance of the Letter of Undertaking dated 19-06-2013 kept alive the debt that was owed and therefore, in any event, the winding-up petition filed after such debt was kept alive would be in time, notwithstanding that it was filed at a subsequent period after the suit. Furthermore, he submitted that in any event, the limitation is a

mixed question of fact and law, and hence at best the matter ought to be remanded to the NCLT, for determination on the same.

JUDGMENT & OBSERVATIONS - Winding-Up Petition

The Hon'ble Supreme Court rejected the arguments of the Respondent that cause of action for the purposes of limitation would include the commercial insolvency or the loss of substratum of the company, and held as hereunder:

"The trigger

for limitation is the inability of the company to pay its debts. Undoubtedly, this trigger occurs when a default takes place, after which the debt remains outstanding and is not paid. It is this date alone that is relevant for the purpose of triggering the limitation for the filing of a winding-up petition. Though it is clear that a winding-up proceeding is a proceeding 'in rem' and not a recovery proceeding, the trigger of limitation, so far as the winding-up

petition is concerned, would be the date of default. Questions as to commercial

insolvency arise in cases covered by Sections 434(1) (c) of the Companies Act,

1956, where the debt has first to be proved, after which the Court will look to

the wishes of the other creditors and commercial solvency of the company as a whole. The stage at which the Court, therefore, examines whether the Company is

commercially insolvent is once it begins to hear the winding-up petition for admission on merits. Limitation attached insofar as petitions filed under Section 433 (e) are concerned at the stage that default occurs for, it is at this stage that the debt becomes payable."

The Hon'ble Court further relied on the judgment in *Softsule*

(P) Ltd., Re[3] referred in

paragraph 23 in *Mediquip Systems (P) Ltd. v. Proxima Medical System GMBH[4]*, which states the law on winding-up petitions filed under Section 433 (a) of the

Companies Act, 1956 correctly. The primary test is set out in paragraph 1, which is that a winding-up petition is not a legitimate means of seeking to enforce payment of a debt which is *bonafide*

disputed by the company. Absent such dispute, the petition may be admitted. Equally, where the debt is *bonafide*

disputed, there cannot be 'neglect to pay' within the meaning of Section 434 (1) (a) of the Companies Act, 1956, so that the deeming provision does not come

into play. Also, the moment there is a *bonafide*

dispute, the debt is then not 'due'. The High Court also correctly appreciates

that whether the Company is commercially solvent is one of the considerations in order to determine whether the Company is able to pay its debts or not.

Having considered the facts on the touchstone of

the provisions of the statute and the precedents, the Hon'ble Court was of the

considered view that:

"There is no

averment in the petition that thanks to these or other facts the Company's substratum has disappeared, or that the Company is otherwise commercially insolvent. It is clear therefore, that even on facts, the company's substratum

disappearing or the commercial insolvency of the company has not been pleaded.

Whereas, in Form-1, upon transfer of the winding-up proceedings to the NCLT, what is correctly stated is that the date of default is 19-08-2012; making it clear that three-years from the date had long since elapsed when the Winding-up

Petition under Section 433 (e) was filed on 21-10-2016."

Consequently, the Civil Appeal was allowed and the

Writ Petition was disposed of by the Hon'ble Court by holding that the winding-up

petition filed on 21-10-2016 being beyond the period of 3 years mentioned in Article

137 of the Limitation Act is time-barred and cannot, therefore, be proceeded with any further. Accordingly, the impugned judgment of the NCLAT and the judgment of the NCLT was set aside.

CONCLUSION

The Hon'ble Supreme Court rightly answered the issue in favour of the Appellant- Shareholder with respect to the present Civil

Appeal. Also, as had been correctly pointed out by learned Senior Advocate for Appellant

Shareholders that the statutory notice given on 03-11-2015, does not refer to any facts as to the commercial insolvency of La-Fin. The statutory notice only

refers to the suit proceedings and attachment by the Economic Offences Wing of

Mumbai Police, which had taken place long before in December, 2013.

Factually,

therefore, no basis was laid down for the legal contentions argued by the learned Senior Advocate for Respondent- IL & FS.

Furthermore, the Commercial Insolvency of the company

had not been pleaded either in the petition or even on facts. The statutory Form-1

also clearly stated that the date of default was 19-08-2012 and hence 3 years from the said date had long since elapsed when the winding-up petition under Section 433(e) was filed on 21-10-2016. In the light of the entire facts, documents on records and the authorities relied upon by the Hon'ble Court, it is crystal clear that the limitation for the purpose of filing a winding-up petition, triggers only on the date of default.

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- [1] WP (Civil) No. 455 of 2019.
 - [2] 2018 SCC OnLine 1921.
 - [3] [(1977) 47 Comp Cas 438 (Bom)]: (Comp Cas pp.443-44)
 - [4] (2005) 7 SCC 42.

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