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Case Comment: Bangalore Sales Corporation v Sark Spice Products Pvt. Ltd.

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INTRODUCTION

The Insolvency and Bankruptcy Code (IBC) was enacted by the Government of India in 2016 and is a cornerstone statute in the development of an efficient and fast-paced insolvency resolution system. A corporate firm turns insolvent when it owes a large volume of debt to a creditor or multiple creditors and cannot fulfill its monetary obligations regarding the same, the reason for such default is more often than not, financial distress¹. Bankruptcy, on the other hand, is a judicial order that details how an insolvent entity should pay off its creditors and which assets are to be sold in pursuance of the same.

Before the enactment of this code, individual insolvency and bankruptcy were governed by two statutes, namely; The Presidency Towns Insolvency Act, 1909², and The Provincial Insolvency Act, 1920³, whereas for the insolvency and bankruptcy proceedings of companies, Sick

¹ Alicia Tuovila, 'Insolvencies: Definition, How It Works, and Contributing Factors' (*Investopedia*, 02 October 2022) <<https://www.investopedia.com/terms/i/insolvency.asp>> accessed 24 January 2023

² Presidency Towns Insolvency Act 1909

³ Provincial Insolvency Act 1920

Industrial Companies (Special Provisions) Act, 1985⁴ was followed. With the onset of the IBC, the functions of these acts were merged into a single statute which successfully enhanced the insolvency and bankruptcy proceedings for individuals and corporate firms, it also mitigated the failures of the pre-existing acts.

Besides this, the IBC also provides the corporate debtor (a corporate person who owes a debt to any person)⁵ with an opportunity to resuscitate himself from insolvency, this is done through the Corporate Insolvency Resolution Process (CIRP) under which a resolution plan is created for the insolvent corporate debtor to stabilise his business and pay off the creditors. However, to set the CIRP in motion and effectively “rescue” the corporate debtor, an application regarding the same has to be filed in the Adjudicating Authority⁶(AA), which the IBC has declared to be the National Company Law Tribunal, (NCLT). The AA can either accept the application which starts the CIRP or reject it, after rejecting the application the corporate debtor is left with only one option, to liquidate the business.

The case of Bangalore Sales Corporation v Sark Spice Products Pvt. Ltd. contested in the National Company Law Tribunal, Kochi Bench forms a vital precedent on the eligibility of an unregistered partnership firm (Bangalore Sales Corporation) which, in this case, is the operational creditor⁷ to apply for the initiation of the Corporate Insolvency Resolution Process (CIRP) under section 9⁸ of the IBC against the corporate debtor (Sark Spice Products Pvt. Ltd.).

FACTS

In this case, the Petitioner “Bangalore Sales Corporation” a partnership firm is an operational creditor to whom the Respondent “Sark Spice Products Pvt. Ltd.” the corporate debtor, owes an operational debt⁹(a debt claim in respect of the provision of any goods or services to the

⁴ Sick Industrial Companies (Special Provisions) Act 1985

⁵ Insolvency and Bankruptcy Code 2016, 3(8)

⁶ Insolvency and Bankruptcy Code 2016, s 5(1)

⁷ Insolvency and Bankruptcy Code 2016, s 5(20)

⁸ Insolvency and Bankruptcy Code 2016, s 9

⁹ Insolvency and Bankruptcy Code 2016, s5(21)

corporate debtor) of Rs. 1,72,15,532. The relief sought by the petitioner is an initiation of the CIRP process under section 9 of the IBC.

On 19.08.2019 the corporate debtor issued a purchase order, according to which the operational creditor delivered the said goods, according to an invoice dated 21.08.2019. The total amount of these goods was Rs. 1,08,10,800 and the duration of payment of the same was 90 days, as per the invoice submitted by the petitioner. The respondent did not pay the amount of money owed to the petitioner in 90 days as per the conditions given in the invoice. Due to this, the petitioner levied a 24% interest on the due amount, on 13.05.2022 the petitioner issued a demand notice under section 8¹⁰ of the IBC seeking to initiate insolvency proceedings against the respondent, after receiving the notice the respondent sends a reply notice on 21.05.2022 and denied having any debt owed to the operational creditor, thereby raising a dispute and leading to this petition being filed.

The minimum default limit set in this case was Rs. 1 crore, as per section 4¹¹ of the IBC, the minimum limit for the initiation of CIRP proceedings is Rs. 1 Lakh, this limit can be extended to Rs. 1 Crore by the Government after giving an appropriate notification about the same. The managing director of the corporate debtor also owns a proprietorship by the name of Kalpaka Processing Co. the corporate debtor held that it paid Rs. 70,00,000 through the Bank account of Kalpaka to the petitioner and the debt balance was reduced to Rs. 38,00,000 which was lesser than the threshold created in this case by section 4 of the IBC thus, the respondent prayed that the petition filed by the OC should be dismissed. The respondent had another contention that, the corporate debtor was in a business transaction with Mr Surajpal head of a sister company of the petitioner in respect of 200 Kgs of Curcumin, in this transaction Surajpal misused the procurement certificate of the Respondent, due to which the MD of the corporate debtor was made liable for Rs. 63 Lakhs for the violation of the Customs Act, the operational creditor would be liable for this violation too, however, this contractual agreement is of no relevance to the present petition, thus is not further deliberated upon by the Tribunal.

¹⁰ Insolvency and Bankruptcy Code 2016, s 8

¹¹ Insolvency and Bankruptcy Code 2016, s 4

Surajpal also owed Rs 1,06,20,000 to Green Natural Extracts Pvt. Ltd. which he was unable to pay and dishonoured the cheque for the payment of the same twice; making the petitioner liable to pay for a debt of Rs. 1,06,20,000. An agreement was entered into by the directors of Green Natural and the corporate debtor on 27.02.2021 for payment of Rs. 90,00,000 out of the total debt of Rs. 1,06,20,000 within 90 days, however, the corporate debtor was only able to pay Rs. 25,00,000 to Green Natural. The petitioner was not a party but a witness to this agreement. Thus, part of the debt of Rs. 90,00,000 out of Rs. 1,72,15,532 for which the debtor was liable, was assigned to Green Natural which reduced the original debt amount from Rs. 1,08,10,810 to Rs. 18,10,810 without interest. The petitioner was not a party to this contract but held that since the respondent was not able to pay off the debt to Green Natural within the stipulated 3 months the agreement became invalid and the debt was reverted to the petitioner and the agreement signed on 27.02.2021 did not change the amount of debt owed. The Tribunal also pondered on the validity of the petitioner as a partnership firm.

LEGAL ISSUES

- Is the respondent liable to pay INR 70,00,000 which were paid through the bank account of Kalpaka Processing Co.?
- Has the Debt reverted to the petitioner after the respondent failed to pay the assignee firm the stipulated amount in 3 months as per the agreement on 27.02.2021?
- After forming the agreement on 27.02.2021 is the Respondent liable to pay the original amount as held by the Petitioner?
- Does a pre-existing dispute exist between the parties and is the interest levied on the debtor valid?
- Is the petition filed by the partnership firm maintainable?

LEGAL DECISIONS

Point 1: The petitioner in reply to the respondent said that the amount of Rs. 70,00,000 paid in four installments was in pursuance of a separate purchase order set by Kalpaka Processing Co. and it wasn't related to the debt owed by the respondent in the current petition, the applicant

also stated the fact that the corporate debtor and the propriety firm are two different corporate persons¹² thus the money received from one entity cannot be credited to the account of another. Based on these arguments the NCLT decided that the evidence presented by the corporate debtor regarding the payment of Rs. 70,00,000 of the total debt is unsatisfactory and thus this contention was dismissed.

Point 2: Regarding the second point, the respondent pointed out some crucial facts, first, if, in the contractual agreement, it is explicitly mentioned that a certain amount of debt shall be assigned to a third party which is nominated by due consent of the assignor and other parties involved, then the creditor/assignor loses his rights over that debt and its emanating monetary obligations and if the debtor defaults then the assignee alone can initiate legal proceedings and not the assignor/creditor. Second, in the agreement made on 27.02.2021, the petitioner has nowhere written a statement authorising their reassignment rights thus, the contention of the petitioner that the debt reverted to them after the corporate debtor failed to make the due payments in three months to the assignee firm, is invalid. As a result Rs. 90,00,000 are to be deducted from the original debt levied on the corporate debtor, without including the interest.

Point 3: In the present petition, the principal amount pleaded by the petitioner is Rs. 1,08,10,532, and an additional interest of Rs. 64,00,732 however, inferring from the decision made in point 2, the amount of debt gets deducted by Rs. 90,00,000. Thus, the principal amount after deduction becomes Rs. 18,10,810 even if we add the interest the debt amounts to Rs. 82,15,532. Both of these amounts are individually under the minimum threshold required to start the insolvency proceedings as per section 4 of the IBC.

Point 4: The petitioner justifies the interest of 24 percent levied on the debtor, to substantiate the same they cite the NCLAT decision on payment of interest accrued with the operational debt. In this decision, the tribunal opined that interest can be a part of the operational debt if it is mentioned as such in the invoice, however for such a clause to get legal validity it must be countersigned by the responding party. In this case, there was a clause in the agreement about

¹² Insolvency and Bankruptcy Code 2016, s 3(7)

the 24% interest but it was not endorsed or countersigned by the respondent, thus making it invalid. In the case of *Jyothi Limited v Boving Fouress Limited*¹³ in 2001, the Karnataka High Court observed that interest cannot be levied by a term in a bill or invoice unless it obtains the approval of the purchasing party, this approval will be obtained after the said party countersigns the interest clause in the agreement. Taking all of the above factors into consideration, the NCLT concluded that a pre-existing dispute did exist and that, the interest levied on the debtor was dismissed.

Point 5: In the petition filed by the applicant it is not mentioned whether the partnership firm is registered with the registrar of firms. The point regarding the maintainability of the petition if the firm turns out to be unregistered is not mentioned by either party. But from the records submitted it is not made clear if the partnership firm is registered with the registrar of firms, this violates Section 69(2)¹⁴ of the Indian Partnership Act, 1932 (IPA), according to this section, an unregistered party is debarred from filing any third party suits on any other partnership firm or company. As this tribunal has the powers of a court, conferred to it by Section 3¹⁵ of the Indian Evidence Act, of 1872 it can hold the petitioner accountable. Thus, the validity of the petitioner as a partnership firm is nullified since it is an unregistered partnership firm. Also, it cannot file suits on any third-party entities, thereby leading to a dismissal of the current petition.

ANALYSIS: CONCLUDING REMARKS

The decisions taken by the NCLT, in this case, are mostly correct, save one, the last point. The Tribunal quite coherently describes its position on the eligibility of unregistered firms to file for insolvency proceedings, it states that for a partnership firm to initiate insolvency proceedings against a debtor it must be registered with the registrar of firms, or else it would not be allowed to do the same. This rule emanates from Section 69(2) of the IPA which says that an unregistered firm cannot file a suit against any third party to enforce a right. It is applied in cases related to insolvency because of section 3(37)¹⁶ of the IBC wherein the code authorises the Tribunal to

¹³ *Jyothi Limited v Boving Fouress Limited* (2001) 3 (Comp LJ) 413

¹⁴ Indian Partnership Act 1932, s 69(2)

¹⁵ Indian Evidence Act 1872, s 3

¹⁶ Insolvency and Bankruptcy Code 2016, s 3(37)

interpret the words and meanings given in special acts (like the partnership act) as they are framed and apply them in cases if required.

The problem regarding the precedent set in this case arises when earlier judgements related to unregistered firms and their right to initiate insolvency proceedings, and, the decision made in the current petition contradict each other. In *Shree Dev Chemicals Corporation v Gammon India Ltd*¹⁷ the NCLT stated that unregistered partnerships can apply to initiate the CIRP under section 9 of the IBC, it also noted that section 69(2) of the IPA has a restriction on “suits” and not “proceedings”, thus an application for starting the insolvency process is not restricted as it is considered a proceeding and not a suit. In the case of *Shree Balaji Steels v Gontermann-Peipers (India) Limited*¹⁸, the tribunal stated that an application under section 9 of IBC would be considered a “petition” and not a “suit” thereby it is not liable to be debarred under the IPA if an unregistered firm does file for the same. However, the decision made in the present petition completely contradicts these prior made precedents thereby creating a legal conundrum.

The NCLT must come up with a concrete decision regarding the rights of unregistered partnership firms initiating the insolvency process as given in the IBC. If the NCLT is unable to do so then, it should urge the Government to amend the IBC and make it a more precise law regarding insolvency proceedings and the qualifications required by a partnership firm to initiate the same.

¹⁷ *Shree Dev Chemicals Corporation v Gammon India Ltd* CP (IB) No.3637/MB.IV/2018

¹⁸ *Shree Balaji Steels v Gontermann-Peipers (India) Ltd* (2002) 114 193 (CompCas)