

DEMYSTIFYING THE LEGAL CONUNDRUM OF “LIMITATION ON ACKNOWLEDGEMENT OF DEBT IN THE BALANCE SHEET OF CORPORATE DEBTOR”*

Introduction

The balance sheet is a financial statement that is often used to find the amount of debt due to be paid to the financial creditors of the company. Section 7 of the Insolvency and Bankruptcy Code¹ facilitates a financial creditor to file an application barred by limitation to initiate a Corporate Insolvency Resolution Process (CIRP) against the corporate debtor. However, the acknowledgement of debt or admission of existing liability in writing before the expiry of the limitation period extends the period of limitation under Section 18 of the Limitation Act, 1963².

The first part of this article dealt with the issue of applicability of Section 18 of the Limitation Act to the proceedings under the Insolvency and Bankruptcy Code. The question of law involved in this proposition is whether the acknowledgement of liability in the balance sheet of the corporate debtor before the expiry of the period of limitation amounts to an acknowledgement of debt under this Section? The author has delved into the conflicting position of law in this regard and also dealt with the issue of acknowledgement of debt in the balance sheet after the expiry of the limitation period and the effect of the Indian Contract Act on the same.

These issues are analysed after drawing inference from the recent judgement of *Asset Reconstruction Company (India) Limited v. Bishal Jaiswal & Anr.*³ where the Hon'ble Supreme Court held the balance sheets can amount to an acknowledgement of debt under Section 18 of the Limitation Act for the purpose of extending the limitation period in matters related to Insolvency & Bankruptcy Code 2016. Further, the article discusses the compulsory nature of filing the balance sheet as a ground for acknowledgement of debt and contentious issues with an attempt to find a plausible solution to the question of law involved in this regard with respect to two scenarios.

* Written by Mr. Monish Raghuwanshi, Executive Student and reviewed by Chittaranjan Pal, Assistant Director, The ICSI

Views expressed in the Article are the sole expression of the Author and may not express the views of the Institute.

¹ The Insolvency and Bankruptcy Code, 2016 § 7, Acts of Parliament, No. 31 of 2016.

² The Limitation Act, 1963 § 18, Acts of Parliament, No. 36 of 1963.

³ *Asset Reconstruction Company (India) Ltd. v. Bishal Jaiswal & Anr.*, Civil Appeal No.323 of 2021.

Question of Application of Limitation Act on The Insolvency and Bankruptcy Code

In order to settle the debate on the question of application of provisions of the limitation act to the Code the legislature brought Insolvency and Bankruptcy Code (Second Amendment) Act, 2018⁴ and inserted Section 238A to the code which states that: “Limitation.—The provisions of the Limitation Act, 1963 (36 of 1963) shall, as far as may be, apply to the proceedings or appeals before the Adjudicating Authority, the National Company Law Appellate Tribunal, the Debt Recovery Tribunal or the Debt Recovery Appellate Tribunal, as the case may be”.⁵

Further, the Hon’ble Supreme Court in *B. K. Educational Services Pvt Ltd. v. Parag Gupta & Associates*⁶ held that “the Limitation Act, 1963 is applicable to applications filed under Sections 7 and 9 of the Code from the inception of the Code, Article 137 of the Limitation Act gets attracted”.⁷

Article 137 is Applicable

It is also pertinent to note that Article 137 of the Limitation Act applies to the provisions of the IBC. Article 137 of the Limitation Act prescribes a limitation period of 3 years for any other application for which no period of limitation is provided elsewhere. The Supreme Court in *Gaurav Hargovindbhai Dave v. Asset Reconstruction Company*⁸ held that the application under Section 7 falls within the ambit of residuary Article 137 which prescribes the period of three years and the right to sue accrues from the date of default.

Applicability of Section 18 of The Limitation Act to the Proceedings Under Section 7 of The Insolvency and Bankruptcy Code, 2016

Section 18 of the Limitation Act provides that where before the expiry of the period of limitation, an acknowledgement of liability is made in writing and signed by the debtor, a fresh period of limitation starts from the time when such acknowledgement was signed. The Hon’ble Supreme Court in *Jignesh Shah v. Union of India*⁹ on the issue of application of Section 18 of the Limitation Act to an application filed u/s 7 of the IBC held that:

“In law, when time begins to run, it can only be extended in the manner provided in the Limitation Act. For example, an acknowledgement of liability under Section 18 of the Limitation Act would certainly extend the limitation period, but a suit for recovery, which is a separate and independent proceeding distinct from the remedy of winding up would, in no manner, impact the limitation within which the winding-up proceeding is to be filed, by somehow keeping the debt alive for the purpose of the winding-up proceeding”.¹⁰

Subsequently, the Apex Court in *Babulal Vardharji Gurjar v. Veer Gurjar Aluminium Industries Pvt. Ltd. & Anr.*¹¹ observed that Section 18 of the Limitation Act is not applicable to proceedings under Section 7 of the Insolvency and Bankruptcy Code, 2016.

⁴ Insolvency and Bankruptcy Code (Second Amendment) Act, 2018, Acts of Parliament, No. 26 of 2018.

⁵ The Insolvency and Bankruptcy Code, 2016 § 238A, Acts of Parliament, No. 31 of 2016.

⁶ *B. K. Educational Services Pvt. Ltd. v. Parag Gupta & Associates*, AIR 2018 SC 5601.

⁷ *Id.* ¶ 27.

⁸ *Gaurav Hargovindbhai Dave v. Asset Reconstruction Company*, 2019 SCC 10 572.

⁹ *Jignesh Shah v. Union of India*, 2019 AIR SC 4758.

¹⁰ *Id.* ¶ 19.

¹¹ *Babulal Vardharji Gurjar v. Veer Gurjar Aluminium Industries Pvt. Ltd. & Anr.*, 2020 SCC Online SC 647.

The apex court further emphasised that the limitation period cannot be extended in the application filed for CIRP, even if there is an acknowledgement of debt in writing by the corporate debtor, which would otherwise start a limitation period. The Hon'ble court relied on the judgement of *Swiss Ribbons Pvt. Ltd. v. Union of India*¹² which held that the legislative intent of the insolvency and bankruptcy is not a recovery mechanism for the creditors rather it is beneficial legislation to provide speedy Corporate Insolvency Resolution Process (hereinafter 'CIRP') to the corporate debtor.

However, the author opines that the said observation of the Hon'ble Court was an *obiter dictum* as the issue of the application of Section 18 of the Limitation Act to the CIRP never arose for consideration before the Supreme Court. Also, on the argument of the respondent on the applicability of Section 18 of the Limitation Act, 1963 to an application filed under Section 7 of IBC, the Hon'ble bench chose not to deal with the issue by stating that it did not arise in the peculiar facts and circumstances of that case.

The whole debate on this issue was finally settled in a recent judgement of the Hon'ble Supreme Court in *Asset Reconstruction Company (India) Ltd. v. Bishal Jaiswal & Anr.*¹³ held that Section 18 of the Limitation Act is applicable for extending the period of limitation to the proceedings under the Insolvency and Bankruptcy Code.

Scenario 1 - When the Acknowledgement of Debt in the Balance Sheet is within the Period of Limitation

The issue at hand here is whether the acknowledgement of liability in the balance sheet of the corporate debtor within the period of limitation is a valid acknowledgement of debt? The above-mentioned question of law traces back to 1949 in the common law case of *Jones v. Bellgrove Properties*¹⁴, where the King's Bench allowed the plaintiff to establish by evidence that his particular debt was included in the total sum of the acknowledged debt being due to the creditors.

Indian courts have also recognised this jurisprudence and the Calcutta High Court in *Bengal Silk Mills Co. v. Ismail Golam Hossain Ariff*¹⁵ have held that the entry of the amount of debt due as creditors in the Balance Sheet amounts to valid acknowledgement under Section 18 of the Limitation Act. Thus, the statement in the balance sheet of a company presented to the creditors and the shareholder of the company and duly signed by the directors constitutes an acknowledgement of the debt.

However, in the case of *In Re Pandam Tea Co. Ltd.*¹⁶ where the language used in the directors' report was contrary to the balance sheet, the Calcutta High court in this regard held that this acknowledgement in the balance sheet is not absolute and is subject to the condition that the balance sheet along with the Directors' report must be taken into account to find out the true meaning and purport of the statements to acknowledge the debt.

Proceeding to the issue related to the nature of an acknowledgement, the Delhi High Court in the case of *Sheetal Fabrics v. Coir Cushions Ltd.*¹⁷ said that the statement in the

¹² *Swiss Ribbons Pvt. Ltd. v. Union of India*, 2019 AIR SC 739.

¹³ *Asset Reconstruction Company (India) Ltd.*, *supra* note 3.

¹⁴ *Jones v. Bellgrove Properties Ltd.*, (1949) 2KB 700.

¹⁵ *Bengal Silk Mills Co. v. Ismail Golam Hossain Ariff*, AIR 1962 Cal 115.

¹⁶ *In Re: Pandam Tea Co. Ltd.*, AIR 1974 Cal 170.

¹⁷ *Sheetal Fabrics v. Coir Cushions Ltd.*, 2005 DLT 120 693.

balance sheet need not indicate the exact nature of liability but it must relate to a present subsisting liability and indicate the existence of a jural relationship¹⁸ between the parties. This existence of a jural relationship means that there should be a relationship of a debtor and a creditor between the parties and the intention to admit such a jural relationship shall be evident in the balance sheet in order to constitute a valid acknowledgement.

Thus, under Section 18 of the Limitation Act, 1963, the balance sheet along with the director's report is to be considered to be a valid acknowledgement of the debt by the Corporate Debtor in respect of the recovery proceedings. The question put up here is whether this principle is applicable to insolvency proceedings?

The full bench of Supreme Court in *Asset Reconstruction Company (India) Ltd. v. Bishal Jaiswal & Anr*, in its judgement dated April 15, 2021, held that balance sheets can amount to an acknowledgement of debt under Section 18 of the Limitation Act for the purpose of extending limitation period in matters related to Insolvency & Bankruptcy Code, 2016.¹⁹

However, the contention against the above proposition is that the filing of financial statements is a statutory compulsion that does not amount to a valid acknowledgement of debt under Section 18 of the Limitation Act. The conflict here is that the balance sheet of the corporate debtor is prepared in accordance with Section 92 (Annual Return) of the Companies Act, 2013 which makes the filing of annual return mandatory failing which the penal provisions under Section 92 (5) of the Companies Act, 2013 get attracted.²⁰

This compulsory requirement of filing the balance sheet makes an obligation on part of the corporate debtor to include the debt payable to the financial creditor even if it is barred by limitation. The NCLAT in the matter of *Gautam Sinha v. UV Asset Reconstruction Company Limited*²¹ held that the nature of acknowledgement of debt should be voluntary and if there is any obligation then it cannot be termed as an acknowledgement.²²

To this, the Hon'ble Supreme Court set aside the NCLAT judgement in the matter of *V. Padmakumar v. Stressed Assets Stabilisation Fund & Anr.*²³ and stated that:

"There is no doubt that the filing of a balance sheet in accordance with the provisions of the Companies Act is mandatory, any transgression of the same being punishable by law. However, what is of importance is that notes that are annexed to or forming part of such financial statements are expressly recognised by Section 134(7). Equally, the auditor's report may also enter caveats with regard to acknowledgements made in the books of accounts including the balance sheet. A perusal of the aforesaid would show that the statement of law contained in Bengal Silk Mills (supra), that there is a compulsion in law to prepare a balance sheet but no compulsion to make any particular admission, is correct in

¹⁸ *Lakshmiratan Cotton Mills Co. Ltd. v. Aluminium Corporation of India*, 1971 AIR 1482.

¹⁹ *Asset Reconstruction Company (India) Ltd.*, *supra* note 3.

²⁰ The Companies Act, 2013 § 92, Acts of Parliament, No. 18 of 2013.

²¹ *National Company Law Appellate Tribunal (Principal Bench, New Delhi), Gautam Sinha v. UV Asset Reconstruction Company Limited*, (Feb 25, 2020).

²² *National Company Law Appellate Tribunal (Principal Bench, New Delhi), G. Eswara Rao v. Stressed Assets Stabilisation Fund & Anr.*, (Feb 7, 2020).

²³ *National Company Law Appellate Tribunal (Principal Bench, New Delhi), V. Padmakumar v. Stressed Assets Stabilisation Fund & Anr.*, (Mar 12, 2020).

law as it would depend on the facts of each case as to whether an entry made in a balance sheet qua any particular creditor is unequivocal or has been entered into with caveats, which then has to be examined on a case by case basis to establish whether an acknowledgement of liability has, in fact, been made, thereby extending limitation under Section 18 of the Limitation Act".²⁴

Conclusively, on interpreting the above propositions of law, it is evident that mere acknowledgement of the debt by the corporate debtor in the balance sheet does not amount to valid acknowledgement as this does not show the intention to admit the debt due to the compulsory nature of filing the balance sheet. However, this balance sheet along with the director's report and auditor's report duly signed is evident in determining the intention of the corporate debtor and ascertaining a valid acknowledgement of debt under Section 18 of the Limitation Act.

Scenario 2 - When the Acknowledgement of Debt in the Balance Sheet is Time Barred

The issue at hand here is whether the acknowledgement of liability in the balance sheet of the corporate debtor after the expiry of the period of limitation amounts to a valid acknowledgement under Section 18 of the Limitation Act. The substantial law on this issue is that the acknowledgement of debt in the balance sheet after the expiry of the period of limitation is not covered within the meaning of Section 18 of the Limitation Act, 1963. This implies that the acknowledgement of liability in the balance sheet must be made before the expiry of the period of limitation.²⁵

This proposition further contends on the point that Section 25(3) of the Indian Contract Act prescribes a debtor to enter into an agreement to pay the whole or part of a debt which a creditor is unable to enforce due to the expiry of the period of limitation. Such an agreement is a promise to pay and this would constitute a novation.²⁶ This will give the creditor a right to form a promise to pay as a basis of an independent suit.²⁷ This means that the creditor can initiate an independent suit for the recovery of debt on the basis of an agreement for a promise to pay even after the expiry of the limitation period. The nature of this promise to pay a time-barred debt must be express and unequivocal under Section 25(3) of the Indian Contract Act. The issue that evolved on this point is whether the acknowledgement after the expiry of the period of limitation in the balance sheet along with the director's report is an express and unequivocal promise to pay and whether the same would create a new right of action.

The current legal jurisprudence elucidates on this issue that the acknowledgement of debt need not be a promise to pay but it must relate to the present subsisting liability. The acknowledgement in the balance sheet of the debtor along with the director's report shows the existence of subsisting liability and not a promise to pay. This merely extends the period of limitation and does not create a new right of action²⁸ as opposed to Section 25(3) of the Indian Contract Act, 1872.

²⁴ Asset Reconstruction Company (India) Ltd, *supra* note 3, ¶ 22.

²⁵ National Company Law Appellate Tribunal (Principal Bench, New Delhi), Akram Khan, Director *Poonam Drums & Containers Pvt. Ltd. v. Bank of India Ltd. and Anr.* (Dec 19, 2019).

²⁶ The Indian Contract Act, 1872 § 25(3), Acts of Parliament, No. 9 of 1872.

²⁷ *M/S Unitel Technology (India) Pvt. v. SMP International & Ors.*, 2014 SCC Online DEL 7118.

²⁸ In Re: Pandam Tea Co. Ltd., *supra* note 16.

Concluding Remarks

The Full Judge Bench judgement in Asset Reconstruction Company is a welcome step as it well corrected the incorrect assumptions created by the Babulal Vardharji Gurjar judgement. The Supreme Court rightly cleared all the air on the issue of applicability of Section 18 of the Limitation Act to the proceedings under the Insolvency and Bankruptcy Code. The court also affirmed that the entries in the balance sheet can be considered in determining the admission of liability under Section 18 of the Limitation Act.

On the detailed perusal of the above-mentioned issues with respect to the effect of limitation on the acknowledgement of debt in the balance sheet, it is concluded that this acknowledgement of debt in the balance sheet along with the director's and auditor's report before the expiry of the period of limitation shall constitute a valid acknowledgement within the meaning of Section 18 of the Limitation Act. In relation to the issue of compulsory filing of the balance sheet, it is concluded that the company is free to exclude a time-barred debt from the balance sheet and declare it to be unacknowledged or barred by limitation in the director's report.

On the position of law on the acknowledgement of liability in the balance sheet after the expiry of the period of limitation, the author concludes that it is not a valid acknowledgement under Section 18 of the Limitation Act. Such acknowledgement merely shows the existence of subsisting liability and is not a promise to pay under Section 25(3) of the Indian Contract Act, 1872.

Henceforth, Section 18 of the Limitation Act is applicable to the proceedings under the Insolvency and Bankruptcy Code. In a scenario where the acknowledgement is within the period of limitation, the balance sheet along with the director's and auditor's report is evident to constitute a valid acknowledgement and in a scenario where this acknowledgement is done after the expiry of the limitation period, it does not amount to valid acknowledgement under the purview of Section 18 of the Limitation Act.
