

NCLAT: Interest accrued during the suspension period under Section 10A not to be excluded while calculating the claim threshold under IBC

In a recent decision, the NCLAT in the case of *Beetel Teletech Ltd. v. Arcelia IT Services Private Limited*¹ made 2 (two) relevant findings on the maintainability of applications under Insolvency and Bankruptcy Code, 2016 (“IBC”):

1. The interest accrued during the suspension period under Section 10A of IBC can be claimed under Section 9 of the IBC and can be computed to trigger the threshold under the IBC.
2. The operational creditor can adjust part-payments received from the corporate debtor towards other debts (as opposed to the unpaid operational debt (invoices) claimed under the Section 9 application).

Section 10A of IBC

Section 10A of the IBC² was introduced with the onset of the COVID-19 pandemic suspending the initiation of any proceedings under Section 7, 9 and 10 of the IBC for any default in payment which is committed during Section 10A period. The Section 10A suspension period is between March 25, 2020 to March 25, 2021 (“Section 10A Period”).

Brief Facts

1. By a judgement dated October 17, 2022, NCLT, Delhi (“NCLT”) dismissed the application filed by M/s Beetel Teletech Limited (“Beetel/Operational Creditor”) under Section 9 of the IBC (“NCLT Order”) seeking initiation of corporate insolvency resolution process (“CIRP”) against M/s. Arcelia IT Services Private Limited (“Arcelia/Corporate Debtor”).
2. The NCLT dismissed Beetel’s Section 9 application on the following 2 (two) grounds:
 - a) The Operation Creditor has claimed interest period from March 25, 2020 to March 24, 2021, which is barred under Section 10A. Hence, the unpaid operational debt cannot be held to be above the minimum threshold limit of INR 1,00,00,000 (Indian Rupees one crore) (as per Section 4 of the IBC).

¹ Company Appeal (AT)(Insolvency) No. 1459 of 2022.

² **Section 10A: Suspension of initiation of corporate insolvency resolution process.**

10A. Notwithstanding anything contained in sections 7, 9 and 10, no application for initiation of corporate insolvency resolution process of a corporate debtor shall be filed, for any default arising on or after 25th March, 2020 for a period of six months or such further period, not exceeding one year from such date, as may be notified in this behalf:

Provided that no application shall ever be filed for initiation of corporate insolvency resolution process of a corporate debtor for the said default occurring during the said period.

Explanation. – For the removal of doubts, it is hereby clarified that the provisions of this section shall not apply to any default committed under the said sections before 25th March, 2020.

- b) That Operational Creditor has adjusted the Corporate Debtor's part payments towards other debts, instead of adjusting it against the unpaid invoice (operational debt) claimed in the Section 9 application.

Issue

1. Whether the interest accrued during the Section 10A Period can be included in computing the threshold limit of INR 1,00,00,000 (Indian Rupees one crore) under IBC?
2. Whether the Operational Creditor can adjust part-payments received from the Corporate Debtor towards other debts?

Findings and Rationale

The NCLAT allowed the appeals, set aside the NCLT Order and revived the Section 9 application while answering both the issues in the affirmative.

Inclusion of interest accrued during the Section 10A Period

1. Section 10A (essentially) bars the initiation of CIRP proceedings for a corporate debtor's default during the Section 10A Period. However, if the default is committed *prior* to the Section 10A Period and *continues thereafter*, Section 10A does not bar the initiation of any CIRP proceedings. Section 10A of the IBC was never intended to cover any default which occurred before the Section 10A Period and continuing thereafter.
2. The aim and objective of Section 10A of the IBC was to protect a corporate debtor from the filing of any insolvency application against it for any default committed during the period when COVID-19 pandemic was prevailing.
3. In the present case, once there is a categorical default by the Corporate Debtor prior to Section 10A Period, the liability to pay interest clocked prior to Section 10A Period and hence, the Corporate Debtor was not entitled to claim the benefit of Section 10A Period.
4. Accordingly, the NCLT Order (that liability of interest which accrued during Section 10A Period should not be computed for triggering CIRP) was misconceived.

Operational Creditor's discretion to appropriate any on-account payment received from the Corporate Debtor against any outstanding debt(s)

1. Under Section 60 of the Indian Contract Act, 1872, if the debtor makes any payment without any appropriation, then the creditor can use his discretion to wipe out any of the remaining debt(s) which is/are due. The right of appropriation lies with the creditor if the debtor does not indicate in what manner the debt is to be discharged.
2. In such circumstances, the creditor has the scope for exercising his right in such a manner so as to put himself in the most advantageous position.
3. Even otherwise, it is well settled business practice that in a debt where the principal amount is outstanding, and the interest has also accrued on the debt, sums paid by the debtor is first applied to the interest by the creditor.
4. In the present facts, the Operational Creditor was entitled to exercise its discretion and adjust against the principal or interest accrued in respect of invoices (which were all pending for payment) other the unpaid invoice (operational debt) claimed in the Section 9 application.
5. There is neither any contravention of the statutory provisions of the Indian Contract Act, 1872, nor any inconsistency in the pattern adopted by the Operational Creditor adjusting payments received from the Corporate Debtor against the principal amount outstanding in respect of other pending invoices or setting off these payments against the interest accrued (and not principal) of these invoices.

Conclusion

In one judgement, the NCLAT has made 2 (two) important findings on distinct, but inter-related issues which go to the core of many operational creditor applications under the IBC.

Findings on inclusion of interest accrued during the Section 10A Period

1. Since the law has been settled that interest can be a component to calculate the threshold under IBC, it has become significant to understand what period of interests can be included in a Section 9 application.
2. This NCLAT's decision is a reaffirmation of its earlier position in *Narayan Mangal v. Vatsalya Builders & Developers Private Limited*³ and is in-line with most creditors' arguments today, i.e., that the debt in itself was not suspended during the Section 10A Period, it was only the remedy under Section 7, 9 and 10 of the IBC that was suspended. Hence, if the debt continues to accrue during the Section 10A Period, there is no basis for the clock on the interest on that debt to stop ticking during that period.
3. The NCLAT's clarification that "*It [Section 10A] was never intended to cover any default which occurred before Section 10A period and continuing thereafter*" also goes a long way in preventing debtors from exploiting the safeguard under Section 10A of the IBC.

Finding on operational creditor's discretion to appropriate payments against any outstanding dues

This interplay on Section 60 of the Indian Contract Act, 1872 and the IBC comes in an important finding upholding the fundamentals of contract law and ensuring that those are not compromised, exploited or ignored in an attempt to further a case under IBC.

In transactions where there are running accounts, or even where there are recurring and parallel financial transactions between 2 (two) parties, the creditor's discretion to appropriate payments is an essential feature for the creditor's internal accounting, risk and financial management.

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³ Judgement dated August 18, 2023, Company Appeal (AT) (Ins.) No. 294 of 2023 (Narayan Mangal v. Vatsalya Builders & Developers Private Limited), NCLAT, New Delhi

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