

The Acknowledgement And Its Effect on Insolvency And Bankruptcy Code

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Bar and Bench

The issue of acknowledgement is important in light of two recent judgments, namely, *V Padmakumar v. Stressed Assets Stabilization Fund (SASF)* and *Anr. and Ishrat Ali Vs. Cosmos Cooperative Bank Ltd.*

Both judgements were passed on March 12, 2020 by a 5-member bench of the National Company Law Appellate Tribunal (NCLAT). In *Padmakumar*, the issue before the bench was whether reflection of debt in the balance sheet of the 'Corporate Debtor' can be considered as an acknowledgement. The NCLAT, by a majority decision of 4:1, held that the reflection of debt in the balance sheet cannot be considered as an acknowledgement of debt for the following reasons:

- i) *As the filing of Balance Sheet/Annual Return being mandatory under Section 92(4) of the Companies Act, 2013, failing of which attracts penal action under Section 92(5) & (6), the Balance Sheet/Annual Return of the 'Corporate Debtor' cannot be treated to be an acknowledgement under Section 18 of the Limitation Act, 1963.*
- ii) *If the argument is accepted that the Balance Sheet/Annual Return of the 'Corporate Debtor' amounts to acknowledgement under Section 18 of the Limitation Act, 1963 then in such case, it is to be held that no limitation would be applicable, because every year, it is mandatory for the 'Corporate Debtor' to file Balance Sheet/Annual Return, which is not the law.*

In view of the Supreme Court's verdict in the case of *BK Education Services Private Limited v. Parag Gupta and Associates*, Article 137 of the Limitation Act, 1963 is applicable to proceedings under the Insolvency and Bankruptcy Code (IBC). Section 18 of the Limitation Act, which deals with effect of acknowledgement, reads as follows:

"18. Effect of acknowledgment in writing – (1) *Where, before the expiration of the prescribed period for a suit or application in respect of any property or right, an acknowledgment of liability in respect of such property or right has been made in writing signed by the party against whom such property or right is claimed, or by any person through whom he derives his title or liability, a fresh period of limitation shall be computed from the time when the acknowledgment was so signed.*

Explanation.--For the purposes of this section,--

- a) *an acknowledgment may be sufficient though it omits to specify the exact nature of the property or right, or avers that the time for payment, delivery, performance or enjoyment has not yet come or is accompanied by a refusal to pay, deliver, perform or permit to enjoy, or is coupled with a claim to set-off, or is addressed to a person other than a person entitled to the property or right;*
- b) *the word "signed" means signed either personally or by an agent duly authorised in this behalf; and...*

From a plain reading of the above section, an acknowledgement is an acknowledgement of liability in respect of a right that has been made in writing, signed by the party concerned. This is further explained in Explanation (a) that an acknowledgement may even be sufficient if it is addressed to a person other than a person entitled to that right.

There have been innumerable judgments that have considered the effect of Section 18 vis-à-vis balance sheets of the company. Cases such as, *LC Mills v. Aluminium Corp of India Ltd*, *In Re Padam Tea Company Ltd*, *Mahabir Cold Storage v. CIT*, *Sheetal Fabrics Vv. Coir Cushions Ltd*, *The CIT-III Vs. Shri Vardhman Overseas Ltd*, and many others have held that balance sheet is a valid acknowledgement to extend the limitation period under Section 18.

In *Re Padam Tea Company*, the principle laid down is that the statement of balance sheet indicating liability is to be read along with the directors' report to see whether both so read would amount to an acknowledgement, and if due procedure for passing the balance sheet was adopted or not.

Further, the Delhi High Court in *Sheetal Fabrics*, referring to *LC Mills*, held that,

"...in order to find out the intention of the document by which acknowledgment was to be construed the document as a whole must be read and the intention of the parties must be found out from the total effect of the document read as a whole."

The NCLAT has relied upon Section 92 of the *Companies Act, 2013* and did not consider the effect of the aforesaid judgments while holding that a balance sheet/annual return is a statutory requirement, and hence, cannot be treated as an acknowledgement. However, I have tried to analyse the balance sheet from another angle.

Under the Income Tax Act, 1961 and various accounting standards, the balance sheet is a document that forms the basis of the income tax returns. The fact that a liability appears in the books shows that the same is admitted by the corporate debtor. It is also settled law that merely because an entry is written off, the same does not distinguish the right of the creditor to recover.

Section 92 of the Companies Act, reliance on which has been placed while rendering the decision, does not govern the contents of the annual return to be filed by a company. It merely gives the broad categories of information that an annual report should contain, disclosing *inter alia* the financial health and statistics of the company, prepared on the basis of Generally Accepted Accounting Standards (GAAP). On the contrary, Section 92(1)(c) states that a company in its annual return must reflect its 'indebtedness'.

Additionally, Schedule III of Companies Act, 2013, which provides for 'General Instructions for Preparation of Balance Sheet and Statement of Profit and Loss of a Company', also distinguishes between an acknowledged debt and an unacknowledged debt for the purposes of recording in the balance sheet.

Similarly, provisions of Order XII Rule 6 of the *Civil Procedure Code, 1908* relating to 'Judgment on Admission', Order 37 relating to 'Summary Suits' and Section 433(e) of the Companies Act, 1956 can be looked at. These provisions can be invoked, *inter alia*, against another party if there is an admission of debt by the said party and balance sheet has been treated to be an admission. Now, let us look at the second aspect of Section 18 of the Limitation Act i.e. whether a letter of undertaking/one time offer letter 'without prejudice' can be considered as an acknowledgement.

The effect of a 'without prejudice' communication is found in Section 23 of the *Indian Evidence Act, 1872*, which reads as follows:
"In civil cases no admission is relevant, if it is made either upon an express condition that **evidence** of it is not to be given, or under circumstances from which the Court can infer that the parties agreed together that **evidence** of it should not be given."

The Patna High Court in 1919 dealt with a case of loot. A statement made by the accused to another person admitting his guilt was admitted as evidence under Section 23. The Court cited a discussion that was made in a previous judgment.

"An offer of compromise, the essence of which is that the party making it is willing to submit to a sacrifice, or to make a concession, is rejected, though nothing at the time was expressly said respecting its confidential character, only if it clearly appears to have been made on the faith of a pending treaty into which the party was led by the confidence of an arrangement being effected.

...In the absence, however, of any express or strongly implied restriction as to confidence, an offer of compromise is clearly admissible and may be material as some evidence of liability, although, as has been said, it may not be proper to inquire into the exact terms offered, as such an offer might have been made for the sake of purchasing peace and without any intention to admit liability to the extent of the claim."

The Patna High Court went on to note,

"In my view, the passage, which I have just cited, very completely establishes that an admission made before an arbitrator is admissible in evidence, although it is for the Court dealing with facts to attach whatever weight it thinks proper to such an admission."

The Allahabad High Court in 1948 was dealing with the effect of a 'without prejudice' letter addressed in a specific performance case whereby the plaintiff, prior to filing of a suit, had agreed to be paid a compensation rather than specific performance. The Court took note of the 'without prejudice' letter and allowed the suit to the extent of compensation only.

Recently, the Supreme Court dealt with a similar issue in [ITC v. Blue Coast Hotels Limited](#), holding that
'...we, thus, find that mere introduction of the words 'without prejudice' have no significance and the debtor clearly acknowledged the debt...'

Considering all of the aforesaid, I feel that the issue of balance sheet and a one-time settlement 'without prejudice' could have been looked at from another angle, and may be treated as an acknowledgement in terms of Section 18 of the Limitation Act, in the event that the requirements of Section 18 are complied with.