Dispute Resolution & ADR

Monthly Newsletter
February 2025

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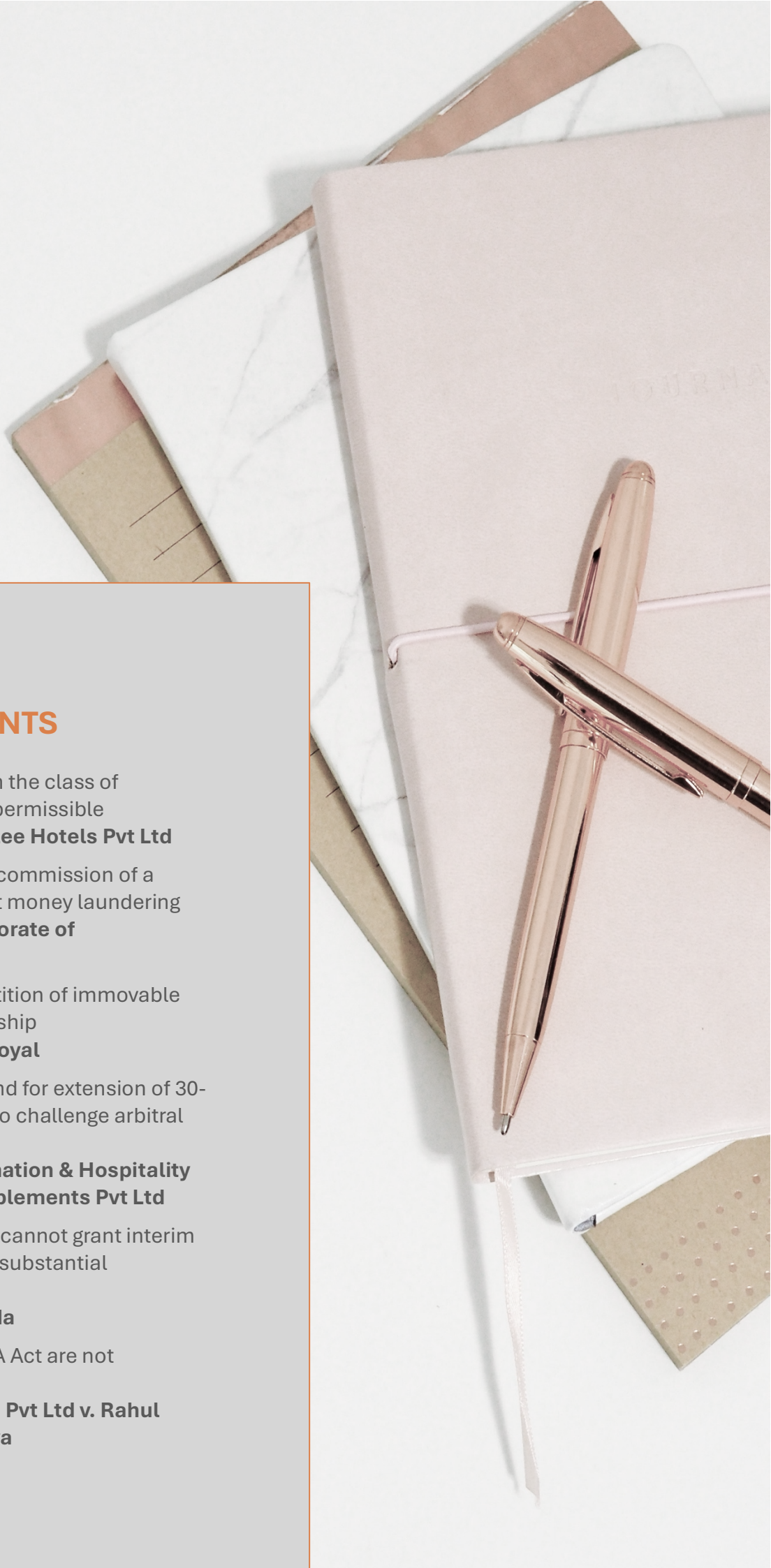

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Sub-classification within the class of operational creditors is permissible

NCC Ltd v. Golden Jubilee Hotels Pvt Ltd

December 11, 2024 | National Company Law Appellate Tribunal, New Delhi
2024 SCC OnLine NCLAT 2052

The National Company Law Appellate Tribunal (**NCLAT**) held that sub-classification within the class of Operational Creditors (**OC**) in the resolution plan to achieve the revival of the Corporate Debtor (**CD**) is within the jurisdiction of the Committee of Creditors (**CoC**) and is permissible within the framework of the Insolvency and Bankruptcy Code, 2016 (**Code**). This decision reinforces the commercial wisdom of the CoC in structuring resolution plans and ensuring that key stakeholders essential to the business's survival – such as landowners, essential service providers, and regulatory bodies – can be accommodated in the resolution process to facilitate continuity and long-term viability. While this strengthens the viability of distressed companies, operational creditors must recognise the inherent risks in insolvency proceedings, as they may not always receive equitable treatment.

SUMMARY OF FACTS

In the CIRP of Golden Jubilee Hotels Pvt Ltd (CD), various OCs filed claims for the different services or supplies provided to the CD – material, construction of the facade, furniture, interior decorations, and the land.

The land was leased by the Youth Advancement Tourism and Culture Department (YATCL) (now, Telangana State Tourism Corporation Ltd) and the Shilparamam Arts, Crafts & Cultural Society (Society) on two different plots on which the CD's hotels were built and was thus crucial to the revival of the CD.

In the resolution approved by the CoC (Plan), YATCL and the Society were classified as 'Special Operational Creditors' (Special OCs) and their claims stood on a different footing than those of the other OCs, as the Plan provided 100% payment of their admitted claims, while providing *nil* payment to the other OCs for their admitted claims.

On account of the inferior position of OCs in the waterfall mechanism under Section 53, all OCs in the instant case were entitled to *nil* payment in terms of Section 30(2) of the Code – a safety net provision for creditors not forming part of the CoC – which mandates that the amount allocated to a creditor under the Plan cannot be less than the amount it would have received if the amount available under the Plan/liquidation value was distributed as per the waterfall mechanism under Section 53.

The Plan was subsequently approved by the National Company Law Tribunal, Hyderabad (NCLT). The other OCs challenged the Plan before the NCLAT.

DECISION OF THE TRIBUNAL

The NCLAT observed that while the Code does not create sub-classification within the class of OCs or mention 'Special Operational Creditors', the Code also does not place an embargo on creating such sub-classification in the resolution plan.

In *Committee of Creditors of Essar Steel India Ltd v. Satish Kumar Gupta*[1], the Supreme Court permitted differential treatment within a class of creditors *inter se* and held that the feasibility and viability of the Plan is left to the wisdom of the CoC and covers all aspects of the Plan including the manner of distribution of funds amongst various creditors; while citing the example of a CoC-approved resolution plan providing full payment to an OC for its electricity dues differential to treatment of other OCs to ensure revival of the CD.

The NCLAT in the instant case noted that instead of allocating *nil* payment to all OCs, the CoC had allocated certain amounts to the Special OCs to ensure the CD's revival as a going concern, consequently reducing the amount allocated to Financial Creditors. Thus, the CoC, in its commercial wisdom, had consciously decided to take a higher haircut with a view to revive the CD, which is the object of the Code.

Noting this, the NCLAT observed the existence of clear business logic to create sub-classification within the class of OCs, which lies within the domain of CoC's commercial wisdom.

The NCLAT reiterated that the scope of jurisdiction available to the NCLT and NCLAT to examine the CoC-approved resolution plan under Section 31 of the Code is limited within the four corners of Section 30(2) (which was not contravened) and does not remotely include any equity-based jurisdiction to assess the commercial wisdom underlying the Plan.

[1] (2020) 8 SCC 531

Collecting funds for the commission of a scheduled offence is not money laundering

Parvez Ahmed v. Directorate of Enforcement

Delhi High Court | December 4, 2024
2024 SCC Online Del 8528

The Delhi High Court held that 'proceeds of crime' that is the core ingredient for the offence of money laundering refers to the funds generated as a result of the commission of the scheduled offence and not funds that are collected for its commission. The High Court also highlighted the primacy of Article 21 of the Constitution of India over the stringent bail conditions under special legislations and the duty of Courts to prevent prolonged incarceration of the accused. This decision reinforces safeguards against premature asset seizures, arrests, and speculative prosecutions, ensuring that funds raised lawfully are not automatically deemed proceeds of crime. It reassures businesses, financial institutions, and civil society while emphasising the need for concrete evidence in money laundering cases. For law enforcement, it underscores the necessity of thorough investigations, preventing misuse of stringent laws and ensuring focus on actual financial crimes.

SUMMARY OF FACTS

Parvez Ahmed, Mohd Ilyas and Abdul Mugeet (accused) were members of the Delhi state unit of Popular Front of India (PFI) and its political front, Social Democratic Party of India (SDPI).

The Directorate of Enforcement (ED) initiated money laundering proceedings against the accused under Sections 3 and 4 of the Prevention of Money Laundering Act, 2002 (PMLA) alleging that the accused have collected funds for and on behalf of PFI from unknown sources and have provided fake receipts to show the collection as a legitimate donation in order to use the funds to commit terrorist activities (scheduled offences). Hence, the funds were alleged to be proceeds of crime concealed by the accused as untainted money.

Even after 2 years since the accused were arrested, the case was pending at the stage of supply of prosecution documents to the accused, and trial had not begun as charges were yet to be framed. As such, all the accused sought regular bail before the Delhi High Court under Sections 439 of the Code of Criminal Procedure, 1973.

Separately, the accused were charged by the National Investigation Agency for the offence of conspiracy to commit terrorist activities and related offences under the Indian Penal Code, 1860 and the Unlawful Activities (Prevention) Act, 1967 (UAPA), which are scheduled offences under the PMLA.

DECISION OF THE COURT

The High Court granted bail to all the accused, subject to them furnishing a bond of INR 50,000 each and not leaving the country without the permission of the Trial Court.

The Court clarified that for invoking the provisions of the PMLA, funds are deemed to be proceeds of crime only when they are generated as a result of the commission of the scheduled offence and not when the funds are collected for the purpose of its commission. As such, the offence of money laundering was not made out.

The Court noted that the accused had been in prison for more than 2 years with no likelihood of conclusion of trial in the near future owing to the stage of the matter and the volume of prosecution evidence involved. Highlighting the principles of bail jurisprudence and the fundamental right to personal liberty guaranteed under Article 21, the Court observed that liberty of an accused under trial is paramount and should be curtailed only by a fair and reasonable procedure under law.

The stringent bail conditions under special statutes like Narcotic Drugs and Psychotropic Substances Act, 1985, UAPA and PMLA are subservient to the fundamental right to liberty guaranteed under Article 21, which takes primacy particularly in case the accused has been incarcerated for an unreasonably long period.

The High Court highlighted the duty of Constitutional Courts (High Courts and the Supreme Court) to be vigilant in protecting the rights of the accused by reading into such statutes involving stringent bail conditions, the requirement of expeditious disposal of cases.

Partner cannot seek partition of immovable property held by partnership

Gokul Bansal v. Vipin Goyal

Madhya Pradesh High Court (Gwalior) | January 8, 2025
Arbitration Case No. 44 of 2021

The High Court of Madhya Pradesh clarified that a partner is only entitled to his share of profits and cannot seek partition of immovable property held by the partnership through physical demarcation. The Court also held that partnership disputes involving third party rights cannot be referred to arbitration. The decision has significant bearing on partnership firms with real estate assets, especially those involving a subject matter over which third party rights (such as tenancy) have been created. The Court's exercise of its limited jurisdiction clarifies the scope of interference permissible at the stage of appointment of the arbitrator and ensures that a meritless claim, which could potentially affect third party interests, is not allowed to proceed through arbitration.

SUMMARY OF FACTS

Om Jai Gurudev, a partnership firm (Firm) formed in 2014, was reconstituted in 2019, reducing the number of partners to only Gokul and the Respondents.

The Firm owned an immovable property at Lashkar, Gwalior having a commercial complex constructed on it.

Gokul claimed a 13% stake in the Firm and repeatedly requested the Respondents to physically divide his share. Since no amicable solution was reached, Gokul invoked arbitration in terms of Clause 11 of the Partnership Deed and sought the appointment of an arbitrator before the Madhya Pradesh High Court, Gwalior bench.

The Respondents, on the other hand, argued that partnership-related disputes, particularly those involving immovable property, are not arbitrable and that the Partnership Act, 1932 provides appropriate remedies before the Civil Court.

DECISION OF THE COURT

Following the principles laid down in *Addanki Narayanappa v. Bhaskara Krishnappa*[2], the High Court clarified that a partner has a right to their share in the partnership firm's profits but not to a specific property, and cannot demand a physical division of their share in the partnership property. A partner can claim the monetary value of his share only upon dissolution or retirement.

Following the decision in *NTPC Ltd v. SPML Infra Ltd*[3] where the Supreme Court held that Courts can refuse arbitration if the claim is meritless, the High Court refused reference of the dispute to arbitration since Gokul's claim was ex facie barred by law despite the limited scope of scrutiny available with the Court at the stage of appointment of the arbitrator.

Placing reliance on *Vidya Drolia v. Durga Trading Corporation*[4] where the Supreme Court held that arbitration should be refused where third party rights are involved, it was observed that since the tenants were in possession of the partnership property and were not parties to the arbitration agreement, they cannot be bound by any decision emanating from the arbitration.

The Court held that where the matter relates to the Partnership Act, 1932 and involves a partnership deed and third party rights, the dispute cannot be referred to arbitration.

[2] (1966) AIR 1300
[3] AIR 2023 SC 1974
[4] (2021) 2 SCC 1

Court holiday is no ground for extension of 30-day condonable period to challenge arbitral award

My Preferred Transformation & Hospitality Pvt Ltd v. Faridabad Implements Pvt Ltd

Supreme Court of India | January 10, 2025
2025 SCC OnLine SC 70

The Supreme Court held that for the purpose of Section 34 proceedings (challenge to an arbitral award), the benefit of Section 4 of the Limitation Act of 1963 allowing parties to institute proceedings on the reopening of the Court (if the prescribed limitation period expires during Court closure/holiday), does not apply when the 3-month period under Section 34(3) of the Arbitration and Conciliation Act, 1996 (**Arbitration Act**) expires when the Court is open and the additional 30-day condonable period under its *proviso* expires on a Court holiday. Lamenting the strict interpretation of 'prescribed period' under Section 4 of the Limitation Act that effectively curtails the remedy available under the Arbitration Act, particularly in light of the growth of arbitration as the preferred dispute resolution mechanism in India, the Court recommended the legislature to take appropriate steps to alleviate this concern. An amendment broadening the scope of 'prescribed period' under the Limitation Act to explicitly include the condonable period provided in legislations would ensure that the beneficial provisions of the Limitation Act can be availed by the parties. In the context of the Arbitration Act involving strict statutory timelines and limited judicial indulgence, such an amendment becomes necessary to foster a more balanced and fair approach.

SUMMARY OF FACTS

In an arbitration arising out of a lease agreement between the parties, My Preferred Transformation & Hospitality Pvt Ltd (MPTHPL) received a physical signed copy of the award on February 14, 2022.

Considering that the period from March 15, 2020 to February 28, 2022 stood excluded from the computation of limitation as per Supreme Court's directions during Covid-19, the 3-month limitation period under Section 34(3) of the Arbitration Act for filing the Section 34 petition (to challenge the arbitral award) started on February 29, 2022 and expired on May 29, 2022.

The additional 30-day period under the *proviso* to Section 34(3) (condonable period) during which the Court may in its discretion condone the delay in filing the Section 34 petition after expiry of the 3-month period, expired on June 28, 2022, which fell during the Delhi High Court's summer vacation between June 4, 2022 and July 3, 2022. MPTHPL filed the Section 34 petition on July 4, 2022, on the date the High Court reopened.

The Delhi High Court dismissed the Section 34 petition as barred by limitation. Aggrieved, MPTHPL approached the Supreme Court on issues involving the scope and interplay of the Limitation Act and Arbitration Act.

DECISION OF THE COURT

On a perusal of Section 29(2) of the Limitation Act and Section 43(1) of the Arbitration Act, the Court observed that the provisions of the Limitation Act (subject to implied exclusions) would apply to arbitrations and Court proceedings under the Arbitration Act as if the periods provided under the Arbitration Act to initiate such proceedings were prescribed under the Limitation Act itself.

The Court was bound by its precedent in *Assam Urban Water Supply & Sewerage Board v. Subhash Projects & Marketing Ltd*[5] involving an identical factual situation, where the Supreme Court held that 'prescribed period' only applies to the 3-month period and not the 30-day condonable period and hence, Section 4 of the Limitation Act does not apply when the 3-month period expires when the Court is functioning and the condonable period expires on a Court holiday/closure.

Before parting, the Court opined its disagreement with the current legal position that narrowly interprets 'prescribed period' to only mean the 3-month period excluding the condonable period, as being excessively stringent and one that requires redressal by the Parliament since the purpose of the Limitation Act is not to curtail the remedy available under the Arbitration Act.

[5] (2012) 2 SCC 624

Second Appellate Court cannot grant interim relief before framing the substantial question(s) of law

U Sudheera v. C Yashoda

Supreme Court of India | January 17, 2025
2025 SCC OnLine SC 104

The Supreme Court recently held that the Second Appellate Court (High Court) cannot pass interim reliefs before formulating the substantial question(s) of law while deciding second appeals. While the decision underscores the importance of adhering to procedural mandates, it raises concerns about the potential miscarriage of justice when procedural technicalities inadvertently impede the overarching substantive rights of parties. The decision effectively reads an absolute bar into the statute which may denude the High Courts' inherent constitutional powers for substantive justice. High Courts must instead be allowed a limited scope to strike a balance between procedural discipline and the broader ends of justice. A rigid interpretation that completely bars interim relief in second appeals could lead to misuse and undue hardship, particularly in cases where irreparable harm may be caused to a litigant before the substantial question of law is even framed.

SUMMARY OF FACTS

In a matter involving the sale of property, one of the buyers (Plaintiff) secured mutation of the revenue records in his favour and filed a suit merely seeking permanent injunction against the other persons claiming to be co-buyers (Defendants). The suit was decreed in his favour.

The Defendants approached the First Appellate Court and the Trial Court's order was set aside since the Plaintiff could not have maintained a suit for bare injunction without declaration of title.

In appeal, the Second Appellate Court (Andhra Pradesh High Court) granted interim relief in the form of *status quo* without forming any substantial question of law.

Aggrieved by the interim relief, the Defendants approached the Supreme Court.

DECISION OF THE COURT

The Supreme Court set aside the interim relief of *status quo* granted by the High Court, holding that the Second Appellate Court (High Court) could not have passed interim orders without formulating the substantive question(s) of law involved.

The Court analysed the jurisdiction of the High Court to entertain second appeals under Section 100 of the Code of Civil Procedure, 1908 and observed that the High Court can proceed to hear a second appeal only after recording that the case involves a substantial question of law. As such, the jurisdiction of the High Court to hear second appeals is invoked only when a substantial question of law arises.

The Court referred to its decision *Manohar Lal Chopra v. Rai Bahadur Rao Raja Seth Hiralal*[6] to clarify that though the High Court possesses inherent power to pass interim reliefs, such power cannot be exercised in contravention of the mandatory statutory provisions.

[6] 1961 SCC OnLine SC 17

Disputes under the RERA Act are not arbitrable

Rashmi Realty Builders Pvt Ltd v. Rahul Rajendrakumar Pagariya

Bombay High Court | October 25, 2024
2024 SCC OnLine Bom 3871

The Bombay High Court held that disputes under the Real Estate (Regulation and Development) Act, 2016 (**RERA Act**) are not arbitrable. The ruling strengthens the consumer-centric framework of the RERA Act by affirming that arbitration clauses cannot override the jurisdiction of RERA authorities. For homebuyers, this ensures access to a specialised forum established for their protection, rather than being forced into arbitration, which may favour the developers and lead to prolonged litigation. For developers, the decision underscores the necessity of strict compliance with RERA's provisions, reinforcing that statutory obligations cannot be bypassed through private agreements. By classifying RERA disputes as *in rem*, the ruling upholds the broader public interest object of the RERA Act of ensuring transparency, accountability, and effective redressal for homebuyers while reinforcing regulatory discipline in the real estate sector.

SUMMARY OF FACTS

Rashmi Realty allotted a flat to Rahul in 2013 *vide* an allotment agreement. Noticing no progress in construction over six years, Rahul filed a complaint with the Maharashtra Real Estate Regulatory Authority, Mumbai (Authority) seeking withdrawal from the project along with a refund of the entire paid amount, interest under Section 18 of the RERA Act, as well as compensation (Complaint).

The Authority rejected the Complaint observing that Section 18 is not applicable since the parties have not entered into a registered sale agreement. The Maharashtra Real Estate Appellate Tribunal, Mumbai reversed the Authority's findings and the Complaint was allowed.

Aggrieved, Rashmi Realty approached the Bombay High Court contending that the Complaint was not maintainable in view of the arbitration clause in the allotment agreement.

DECISION OF THE COURT

To decide on the issue of arbitrability, the Court took note of two important judgments:

- In *Booz Allen and Hamilton INC v. SBI Home Finance Ltd*[7], the Supreme Court distinguished between actions *in rem* (determining a person's right over a property exercisable against the world at large) and disputes *in personam* (arising from civil and commercial relationships between the parties and determining the rights and liabilities of parties *inter se*), holding that the former are not arbitrable. Subordinate rights *in personam* arising from actions *in rem* such as landlord-tenant disputes governed by the Transfer of Property Act, 1882 are also arbitrable.
- In *Vidya Drolia v. Durga Trading Corporation*[8], the Supreme Court held that if the statute provides a specified Court or forum to determine the rights and avail the remedies prescribed under the statute that are beyond the ordinary domain of Civil Courts or the dispute affects third party rights, requires centralised adjudication, involves fraud that goes to the root of the agreement/arbitration clause, or relates to inalienable, sovereign and public interest functions of the State, the dispute is not arbitrable.

The Court analysed the powers and functions of the Authority, and the rights and remedies under the RERA Act and concluded that it is a special legislation with unique provisions, and held that RERA disputes are not arbitrable for the following reasons:

- RERA disputes are *in rem* disputes as a decision by the Authority on a complaint filed by an individual allottee would affect the rights of other allottees in the same building or project.
- Adjudication under the RERA Act is a matter of public policy and is done in the public interest.
- RERA Act creates special rights with special forums for adjudication and enforcement of special rights that are beyond the domain of Civil Courts.
- The locus to institute a complaint lies not only with individual allottees but also with voluntary consumer associations and under *suo moto* powers with the Authority.

Thus, the Court held that the existence of an arbitration clause would not oust the jurisdiction of the Authority under Section 20 of the Act.

[7] (2011) 5 SCC 532
[8] (2021) 2 SCC 1

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