

**IN THE NATIONAL COMPANY LAW TRIBUNAL, MUMBAI BENCH
COURT III**

M.A. 05/2019

Under Section 66(1) of Insolvency &
Bankruptcy Code, 2016

Filed by
Venkatesan Sankaranarayanan, the
Resolution Professional for RTIL Limited
...Applicant

Vs.

Nitin Shambhukumar Kasliwal & Ors.
...Respondent(s)s

In the matter of

C.P. No. 382/I&BP/MB/2018

Edelweiss Asset Reconstruction Company
Limited

...Financial Creditor

Versus

RTIL Limited.

Corporate Debtor

Order delivered on: 29.11.2021

Coram:

Hon'ble Shri H.V. Subba Rao, Member (Judicial)
Hon'ble Shri Chandra Bhan Singh, Member (Technical)

Appearance:

For the Liquidator: Ms. Sandhya Lyer, Mr. Tarak Shah and Ms.

Krithika Dinesham i/b Vaish
Associates

For the Respondent: Mr. Shyam Kapadia a/w Gaurav Shravat
i/b Vishal S Shriyan

Per: Shri Chandra Bhan Singh, Member(T)

ORDER

1. The above Misc. Application has been filed by RP/Liquidator, Venkatesan Sankaranarayanan against the Promoters/Directors of the Corporate Debtor Company namely RTIL Limited under Section 66 of the Insolvency and Bankruptcy Code, 2016. The present M.A. has been filed by RP /Liquidator based on the forensic Audit Report by the forensic Auditor KPMG. The Applicant has relied upon forensic Audit Report in which certain transaction by the forensic Auditor has been highlighted as potentially fraudulent. In the M.A., the Applicant has mentioned the following grounds which according to it would qualify as fraudulent transactions:

- i. Write-off by debtors: The Applicant has alleged that the assets base of the Corporate Debtor was reduced due to Write-off by the debtors of the Corporate Debtors amounting to Rs. 1019.48 crores as on 31.03.2016.
- ii. Reduction in carrying value of stock/inventory: The Applicant mentions that there was increase in the purchase of raw material by the Corporate Debtor during the years 2013 and 2014 and subsequently as of 31st March, 2016 the value of inventory was reduced by 551.74 crores by giving deep discounts.
- iii. Linked entities: The Applicant mentions that the entities from whom purchases were made or whose debts have been written-off are linked to each other. The Applicant also mentions that these interse linked entities have common email IDs/common Auditors/common

Directors etc. and that details of fixed assets of such entities were not available in public domain.

- iv. Capital Advances written off: The Applicant mentions that the Corporate Debtor has written-off capital advance credit of Rs. 213.38 crores during the limited review period of the Forensic Audit conducted by KPMG.

2. Before proceeding further on the matter, this Bench would refer to Section 66 of the IBC relating to fraudulent transaction which reads as under:

Section 66: Fraudulent trading or wrongful trading.

“...(1) If during the corporate insolvency resolution process or a liquidation process, it is found that any business of the corporate debtor has been carried on with intent to defraud creditors of the corporate debtor or for any fraudulent purpose, the Adjudicating Authority may on the application of the resolution professional pass an order that any persons who were knowingly parties to the carrying on of the business in such manner shall be liable to make such contributions to the assets of the corporate debtor as it may deem fit.”

- 2.1. The Bench is of the view that the scope of Section 66 of IBC is to demonstrate that the business of Corporate Debtor has been carried on with the “**intent to defraud**” its creditor or for “any **fraudulent purpose**”. Therefore, while looking into the purported/alleged fraudulent transaction it has to be clearly established that the transaction were made with intension to defraud /fraudulent purpose.
3. The Bench in the succeeding paragraphs would analyse, as mentioned by the Applicant alleged fraudulent transaction

and see whether the Respondent(s) have acted in a malafide fraudulent manner in taking these business decisions. The pointwise analyses in this regard is as under:

3.1. Write-off debts of the Corporate Debtor and therefore a potential fraud:

3.1.1. The Bench notes that the condition under which this amount of Rs. 1019.48 crores has been written off and has been recorded in the minutes of the board meeting dated 27.10.2016 which is as follows:

“...The Audited Financial Statement for the 18 months period ended on 31.03.2016 were placed before the Board. It was noted that the Audit Committee had reviewed the Statements and recommended the same to be Board.

The financial statements of the Company for the period 18 months ended on 31.03.2016 were read out to the Board. It was highlighted that the sales revenue of the Company has dropped by about 67% from Rs. 1045 crores (18 months) to Rs. 348 crores (18 months) in the current year. The various notes in the financial statements regarding the closure of the businesses at the Suit Factory, Bengaluru and the Ready to Wear Garment businesses, Bengaluru was also read. The board was informed that the total loss incurred by the company during the period is Rs. 1661.13 crores.

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It has been brought to the notice of the Board of Directors that the Company's out sourcing and contract

manufacturing business has suffered due to non-availability of working capital and hence Company was unable to buy new stocks and keep the business rolling. The major wholesale dealers of this line of business have been defaulting to making payments and have been raising quality issues, lack of assortment, poor market conditions and high pricing by the company. Faced with the problem of non-collection from the dealers the Company was forced to take back the unsold stocks from some of the dealers and had to resell the same at huge discounts.

In other cases, where the recoveries are difficult and no progress on the collections was possible even after repeated and vigorous follow up, the wholesale dealers have been served with legal notices demanding the payment of dues and threatening them with various consequences like invocation of arbitration, civil and Criminal proceedings against them. Since there has been not much progress on this front and that the amounts due appeared to be doubtful of recovery, the Company has considered it prudent to make provisions in the books of account for the doubtful recovery of the dues from these dealers.

A detailed break up showing customer wise division wise outstanding as at 31st March, 2016 amounting to Rs. 1019.48 crores is presented to the Board and approval of the Board is sought to make provision for doubtful recovery of the dues in the financial accounts of the Company for the period ended on 31.03.2016 for an equivalent amount.

Under the above circumstances, the Company shall continue pursue various legal remedies available to the Company as may be advised by the legal consultant.

Further, the economic indicators and poor sentiment in the industry are also leading to delayed collections from the dealers, ultimately resulting in sales returns and subsequent discounted sales at a loss.

During the year the Company was forced to liquidate non-moving and slow-moving inventory in outsourced/contract manufactured SBUs amounting to Rs. 700 crores at discount ranging from 60% 85% there by incurring huge loss...”

- 3.1.2. The Bench notes that the reasons for write off has been discussed both in the Audit committee as well as the Board of the Corporate Debtor. The reasons for which manufacturing is suffering including non-availability of working capital has been discussed which along with factors like doubtful recovery etc. is leading to write off in the Books of Accounts.
- 3.1.3. The Bench further notes that even subsequent to the Write-off, the Corporate Debtor continued to enforce its legal remedies against the wholesale dealer who had defaulted for the repayment obligation towards Corporate Debtor. It is also noted that the Corporate Debtor continued to address legal notices to the wholesale dealers demanding upon them to discharge their payment obligation towards Corporate Debtor. The bench also notes that it is obligatory on the part of all entities including Corporate Debtor to

make provisions for receivable whose recovery is doubtful on the basis of fair and best estimate of its realisability. In this regard, the Bench notes that the Accounting Standards expressly provides that the entity is obliged to make provisioning of the doubtful recovery. In this case the Bench further notes the wholesale dealers been defaulted in their payment obligation towards the Corporate Debtor, therefore, the Corporate Debtor on the basis of fair and best estimates of Statutory Auditor provisioned these receivables from the wholesale dealers as doubtful.

3.1.4. The whole exercise of write-off as per the accounting standards and consequential steps cannot be considered to be fraudulent. In this regard as submitted by the Respondent(s), it is worthwhile to refer the Judgement of Hon'ble Supreme Court in the case of **Salim Akbarali nanji Vs Union of India & Ors**, the relevant part of judgment is as follows:

“17. The submission proceeds on the assumption that the bad debts written off cannot be recovered. In fact and in law it is not so. Despite writing off the debt is still recoverable by the Bank. The affidavit filed by the Bank also discloses the steps which are being taken to realize the due from the debtor. Some amounts have been recovered over the year though the figure does not appear very impressive. Even so, steps are being taken to recover the dues whenever possible and Respondent(s) No. 6 bank has furnished particulars of the various proceedings pending for recovery of such debt. The write off is only an internal accounting procedure to clean up the balance sheet, and it does not affect the right

of the creditor to proceed against the borrower to realize his dues. Moreover, it does give some benefit to the Bank under the Income-Tax Law because after write off tax is payable only on the amount recovered as and when recovery is made...”

3.1.5. Therefore, the Bench is of the considered view that, the write off in an Internal Accounting Procedure which is necessarily to be followed by any corporate entity and these write off do not demonstrate any fraudulent trading and the Applicant is incorrect such write off to be fraudulent.

3.2. Increase in the purchase of material during 2013-2014 and thereafter reduction in carrying value of stock/inventory:

3.2.1. The Applicant mentions that during the review period, inventory of an amount of about Rs. 700 crores was sold at a heavy discount by the Corporate Debtor thereby incurring heavy losses and also reducing the carrying value the stock/inventory. The Respondent(s) mentions that in order to increase business activity, increase sale and revised the business of the Corporate Debtor, the purchase of raw material were made in 2013-2014. This action was undertaken with the bona fide intention of increasing manufacturing activity and turn-over of the Corporate Debtor. However, the Corporate Debtor submits that by financial year 2015-16, the Corporate Debtor was in mode of “closure of business” and accordingly the stock lying with the Corporate Debtor had to be sold at deep discount

rates. The Bench notes and as mentioned by the Corporate Debtor that the stocks were combination of old and accumulated stocks and a part of which was defective and non-moving stocks, lying with the Corporate Debtor. Considering that, the Corporate Debtor was in the mode of “closure of business”, the sale was a “firesale” or “distress sale” conducted by the Corporate Debtor to clear the redundant stock and salvage whatever value that was possible to be recovered. The Bench notes that these actions cannot be considered to be fraudulent activity or with a view to defraud the creditors of the Corporate entities.

3.2.2. The Bench further notes that the Applicant in its application has also mentioned that the documents relating to purchase of material are not available for review. However, the Bench notes that the Respondent(s) No. 1 submits that if the relevant invoices for purchase of material itself was not available then how such transactions could have been entered in the books of accounts of the Corporate Debtor as purchase of materials. The bench notes that in ordinary business without corresponding invoices no payment for material can be entered in the books of accounts.

3.2.3. The Bench also notes that the Corporate Debtor was a subsidiary of public listed company ‘S Kumar Nationwide Limited’. The audited financial statements of both these entities are available in the public domain on the website of the stock exchanges, Ministry of Corporate Affairs etc. and therefore easily available for review by anyone. The

Bench notes that none of the investors, shareholders and lenders such as State Bank of India, IDBI, Bank, ICICI Bank Ltd. etc has ever raised any concerns relating to fraud being conducted by Respondent(s) and there is no reference to any such things in the financial statement of the Corporate Debtor for the relevant period. None of these entities have ever mentioned that adequate documentation relating to purchase of materials are not available. Therefore, the Bench finds these charges to be unsubstantiated.

3.2.4. The Bench is also of the view that no gain was made by the Respondent(s) through these transactions. Therefore, the Applicant cannot call these reductions in inventory/stock to be a fraudulent act of the Respondent(s).

3.3. Linked entities purchases were made which is potentially fraudulent

3.3.1. The Applicant has alleged that the debts which have been written off are linked entities to each other, who have common email IDs, common auditors, common directors etc. Therefore, as per the Applicant it amounts to fraudulent transaction. In this regard, the Bench notes that the entities from whom material were purchased by the Corporate Debtor may have been linked to each other, however, this fact does not in any manner make the material purchase transaction between the Corporate Debtor and such linked suppliers/vendor questionable or fraudulent. The Bench notes that the Corporate Debtor has put several reasons for these vendors being linked including the fact that these entities are interese

potentially owned by family members. However, the Bench notes that these entities are not at all in any manner linked to the Corporate Debtor or Respondent(s). The Bench is of the view that the Applicant has not provided any information /documents which may lead to an understanding that suppliers/vendors are connected or linked with the Corporate Debtor / Respondent(s).

3.3.2. The Applicant also alleges that it is fraudulent transaction because Mr. Shyam Malpani and Associates who were statutory auditor for Corporate Debtor from 01.03.2012 to 30.09.2014 were also statutory auditor of some of the supplier/vendors. The Bench notes that Mr. Shyam Malpani and associates was setup in 1992 and in 2006, as mentioned by the Respondent(s), the staff strength of the statutory auditor group included 13 Chartered Accountants with locations at various cities in the country. The Bench notes that mere existence of common statutory auditors between the Corporate Debtor and some of suppliers/vendors in no way categories transactions as fraudulent or wrongful trading.

3.4. Capital Advances written off which according to the Applicant hints at potential fraud:

3.4.1. The Bench notes that the Capital advances written off by the Corporate Debtor were with respect to project for establishing a manufacturing project that could not be completed and had to be abandoned. The Corporate Debtor mentions that the write off of Capital Advances of Rs. 213.38 crores during the review period was mainly an

adjustment in the books of accounts of the Corporate Debtor by setting off debit balances. The bench notes that no actual payments were made from the account of the Corporate Debtor. Based on the submission of Respondent(s) the particulars of these capital advances are as under:

- a. *These were the debit balances appearing against the parties as capital advances to different vendors to acquire machinery for manufacturing high quality fabrics for export to the US market through its group company HMX INC, which was based in the USA.*
- b. *These capital advances were grouped under the category "Capital Work in Progress".*
- c. *However, HMX Inc filed voluntary petition under Chapter 11 with the United States Bankruptcy Code and the business of HMX Inc was auctioned off by the Bankruptcy Code.*
- d. *However, since the recovery of dues seem doubtful, necessary provisioning has been made in the books.*
- e. *The amount in question is the debit balance in the books of account and no payments, either by cheque or cash, were made by RTIL.*

3.4.2. The Bench notes that the aforesaid reasons for writing off capital advances has been clearly set out in the minutes of the board meeting dated 15.10.2015 of the Corporate Debtor forming part of the Application.

3.4.3. The Bench also notes that these are debit balances appearing against these parties and no payment by cheque or cash have been made in this respect and that the

Respondent(s) had provided all relevant details and explanation in relation to the write off to its lender at relevant time. The Bench therefore is of the view that these advances write off can not be termed as fraudulent transaction.

4. The Bench in addition, based on the submissions by the Respondent notes that there has been other part audits of the books of accounts of the Corporate Debtor. The details of which are as under;

- i. The lenders carried out a Special Audit of the group (including the Corporate Debtor and its group companies) for six years ending 31st March, 2013 by E&Y and there were no observations by the auditors regarding any wrong doing.
- ii. Subsequent to the above audit another special audit was conducted by the lenders by appointing M/s T R Chadda and Company, Chartered Accounts for the period from 1st April 2013 to 30th September 2014 for both S Kumar Nationwide Limited and the Corporate Debtor and there were no observations regarding fraudulent trading.
- iii. The lenders were earlier carrying out stock and current assets audit of the Corporate Debtor for many years and there were no negative observations.
- iv. The lenders had also appointed Ray and Ray, Chartered Accounts, Kolkata and Batlibouy and Purohit, Mumbai who conducted concurrent audit on the Group companies for several years

and there were no observations regarding fraudulent trading.

5. The Bench notes that in none of these audits there is any negative observation or any observation relating to any fraudulent transaction.
6. The Bench observes that it is a fact that management of company have taken certain decision which has not worked out as intended by the management and eventually loss occurred. However, such bad commercial business decision cannot be considered to be fraudulent or wrongful trading under provisions of Section 66 of the IBC.
7. The Bench in conclusion, therefore is of the view that the transaction review report has only highlighted that certain transaction may be potential fraudulent transaction. However, the transaction review report does not have any reference to siphoning of or diversion of funds in any manner. Therefore, there is no credible rational input based on which a Section 66 application can be entertained and application deserves to be dismissed.
8. With the above observation the M.A.05/2019 in CP No. 382/2018 stands dismissed and is disposed of accordingly.

Sd/-

CHANDRA BHAN SINGH
MEMBER (TECHNICAL)

Sd/-

H.V. SUBBA RAO
MEMBER (JUDICIAL)