

NCLAT: Section 186 Violation No Shield for Corporate Debtor's Repayment Obligation

Background and Appeal:

The National Company Law Appellate Tribunal (NCLAT), New Delhi Bench comprising Justice Rakesh Kumar Jain (Judicial Member), Mr Naresh Salecha, and Mr Indevar Pandey (Technical Members), recently ruled in the matter of *Pancham Studios Pvt Ltd. v. Konark Aquatics & Exports Pvt Ltd.* The NCLAT addressed whether a corporate debtor could avoid its obligation to repay debt citing non-compliance with Section 186 of the Companies Act, 2013. The appellate proceedings arose from a National Company Law Tribunal (NCLT) order dismissing an application under Section 7 of the Insolvency and Bankruptcy Code, 2016 (IBC).

Contentions of the Parties:

The appellant maintained that the funds had been disbursed to the corporate debtor (CD) to enable repayment of financial liabilities owed to secured creditors under a One-Time Settlement (OTS) arrangement. Despite the completion of the OTS and multiple demand notices issued between August 2019 and May 2022, the respondent allegedly failed to repay the amount.

Conversely, the respondent argued that the interest-free loan lacked a fixed repayment date or written agreement and thus did not qualify as “financial debt” under Section 5(8) of the IBC. The respondent further contended that the transaction breached Section 186 of the Companies Act, which restricts companies from granting interest-free loans beyond a prescribed threshold without proper approvals.

Objective of Section 186 of the Companies Act:

NCLAT clarified that Section 186(2) imposes restrictions on companies from giving loans exceeding 60% of their paid-up share capital, free reserves, and securities premium account. Section 186(13) prescribes penalties for violations, including fines and imprisonment for the company and its officers. However, NCLAT emphasized that the section's aim is to protect shareholders and stakeholders from excessive lending by management not to render such loans void or irrecoverable.

NCLAT's Analysis: Violation Does Not Void the Transaction:

Crucially, the Tribunal observed that nowhere does Section 186 provide that contravening its limits automatically nullifies the loan transaction or extinguishes the corporate debtor's repayment obligation. The Tribunal recognized that statutory breaches can attract regulatory consequences but do not affect the recoverability of the debt itself. Thus, the corporate debtor cannot use a violation of procedural company law to evade substantive liability for repayment.

Assessment of Financial Debt and Default:

The NCLAT found that the amount advanced by the appellant was consistently shown in the corporate debtor's balance sheet as an unsecured loan. Non-payment of this sum despite repeated demand notices constituted a clear and documented default within the meaning of the IBC. The NCLT's decision to dismiss the Section 7 application was, therefore, erroneous.

Conclusion: Appeal Allowed:

NCLAT concluded that a corporate debtor cannot invoke Section 186 as a defense to avoid repayment of its legally due debts. The legislative intent behind the provision is protection, not immunity. Since the disbursed amount clearly qualified as a financial debt and the appellant proved default, the appeal was allowed, and the Section 7 application under the IBC was reinstated.

Takeaway for Stakeholders:

This NCLAT decision affirms that technical violations of company law governing loan disbursement cannot be weaponized by borrowers to shirk repayment responsibilities under insolvency law. Creditors whose advances are duly reflected and undisputed in company records retain their right to seek insolvency resolution, reinforcing accountability and creditor protection under the IBC regime.