Indian Institute of Insolvency Professionals of ICAI (IIIPI)
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IIIPI Case Update #8 November 2017

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1. The expression "and" occurring in section 8(2)(a) may be read as "or" in order to further the object of the statute and/or to avoid an anomalous situation - once the operational creditor has filed an application, which is otherwise complete, the adjudicating authority must reject the application under Section 9(5)(2)(d) if notice of dispute has been received by the operational creditor or there is a record of dispute in the information utility - So long as a dispute truly exists in fact and is not spurious, hypothetical or illusory, the adjudicating authority has to reject the application - A "dispute" is said to exist, so long as there is a real dispute as to payment between the parties that would fall within the inclusive definition contained in Section 5(6) - **Mobilox Innovations Private Limited (Supreme Court)**
2. Insolvency and Bankruptcy Code, 2016 has come into force with effect from 1st December, 2016 and therefore, the right to apply under this Code accrues only on or after 1st December, 2016 - **Black Pearl Hotels Pvt. Ltd. (NCLAT)**

SUPREME COURT OF INDIA

Mobilox Innovations Private Limited (Appellant/Corporate Debtor)

Vs.

Kirusa Software Private Limited (Respondent/Operational Creditor)

Date of order: 21-09-2017

Section 9 read with Section 8 of the Insolvency and Bankruptcy Code, 2016 – Application for initiation of corporate Insolvency resolution process by operational creditor

In terms of purchase order issued by the Appellant/Corporate Debtor the Respondent/Operational Creditor provided certain services and raised monthly invoices between December, 2013 and November, 2014. The bills so raised were payable within 30 days of receipt by the appellant. It is pertinent to note here that a non-disclosure agreement (NDA) was executed between the parties on 26th December, 2014 with effect from 1st November, 2013. In view of non-payment of dues, a demand notice dated 23rd December, 2016 was sent by the respondent under Section 8 of the Code. To this notice, the appellant responded that there exists serious and bona fide disputes between the parties and that nothing was payable as the respondent had been told on 30th January, 2015 that no amount would be paid to the respondent since it had breached the NDA.

The NCLT rejected the application filed under section 9 of the Code on the ground that the default payment being disputed by the Corporate Debtor and that, the operational creditor has admitted that the notice of dispute has been received, the claim made is hit by Section (9)(5)(ii)(d) of the Code.

On appeal the NCLAT set aside the order of the NCLT and remitted the case for consideration with the following observation:

> "In the present case the adjudicating authority has acted mechanically and rejected the application under sub-section (5)(ii)(d) of Section 9 without examining and discussing the aforesaid issue. If the adjudicating authority would have noticed the provisions as discussed above and what constitutes 'dispute' in relation to services provided by operational creditors then it would have come to a conclusion that condition of demand notice under sub-section (2) of Section 8 has not been fulfilled by the corporate debtor and defence claiming dispute was not only vague, got up and motivated to evade the liability."

On appeal, the Supreme Court held as follows:

The adjudicating authority, when examining an application under Section 9 of the Act will have to determine:

(i) Whether there is an "operational debt" as defined exceeding Rs.1 lakh? (See Section 4 of the Act)

(ii) Whether the documentary evidence furnished with the application shows that the aforesaid debt is due and payable and has not yet been paid? and

(iii) Whether there is existence of a dispute between the parties or the record of the pendency of a suit or arbitration proceeding filed before the receipt of the demand notice of the unpaid operational debt in relation to such dispute?

If any one of the aforesaid conditions is lacking, the application would have to be rejected.

Apart from the above, the adjudicating authority must follow the mandate of Section 9, and in particular the mandate of Section 9(5) of the Act, and admit or reject the application, as the case may be, depending upon the factors mentioned in Section 9(5) of the Act.

Another thing of importance is the timelines within which the insolvency resolution process is to be triggered. The corporate debtor is given 10 days from the date of receipt of demand notice or copy of invoice to either point out that a dispute exists between the parties or that he has since repaid the unpaid operational debt. If neither exists, then an application once filed has to be disposed of by the adjudicating authority within 14 days of its receipt, either by admitting it or rejecting it. An appeal can then be filed to the Appellate Tribunal under Section 61 of the Act within 30 days of the order of the Adjudicating Authority with an extension of 15 further days and no more.

Section 64 of the Code mandates that where these timelines are not adhered to, either by the Tribunal or by the Appellate Tribunal, they shall record reasons for not doing so within the period so specified and extend the period so specified for another period not exceeding 10 days. Even in appeals to the Supreme Court from the Appellate Tribunal under Section 62, 45 days time is given from the date of receipt of the order of the Appellate Tribunal in which an appeal to the Supreme Court is to be made, with a further grace period not exceeding 15 days. The strict adherence of these timelines is of essence to both the triggering process and the insolvency resolution process. One of the principal reasons why the Code was enacted was because liquidation proceedings went on interminably, thereby damaging the interests of all stakeholders, except a recalcitrant management which would continue to hold on to the company without paying its debts. Both the Tribunal and the Appellate Tribunal will do well to keep in mind this principal objective sought to be achieved by the Code and will strictly adhere to the time frame within which they are to decide matters under the Code.

It is, thus, clear that so far as an operational creditor is concerned, a demand notice of an unpaid operational debt or copy of an invoice demanding payment of the amount involved must be delivered in the prescribed form. The corporate debtor is then given a period of 10 days from the receipt of the demand notice or copy of the invoice to bring to the notice of the operational creditor the existence of a dispute, if any. The notes on clauses annexed to the Insolvency and Bankruptcy Bill of 2015, in which "the existence of a dispute" alone is mentioned. Even otherwise, the word "and" occurring in Section 8(2)(a) must be read as "or" keeping in mind the legislative intent and the fact that an anomalous situation would arise if it is not read as "or". If read as "and", disputes would only stave off the bankruptcy process if they are already pending in a suit or arbitration proceedings and not otherwise. This would lead to great hardship; in that a dispute may arise a few days before triggering of the insolvency process, in which case, though a dispute may exist, there is no time to approach either an arbitral tribunal or a court. Further, given the fact that long limitation periods are allowed, where disputes may arise and do not reach an arbitral tribunal or a court for upto three years, such persons would be outside the purview of Section 8(2) leading to bankruptcy proceedings commencing against them. Such an anomaly cannot possibly have been intended by the legislature nor has it so been intended. One of the objects of the Code qua operational debts is to ensure that the amount of such debts, which is usually smaller than that of financial debts, does not enable operational creditors to put the corporate debtor into the insolvency resolution process prematurely or initiate the process for extraneous considerations. It is for this reason that it is enough that a dispute exists between the parties. It is settled law that the expression "and" may be read as "or" in order to further the object of the statute and/or to avoid an anomalous situation.

In the first Insolvency and Bankruptcy Bill, 2015 that was annexed to the Bankruptcy Law Reforms Committee Report, Section 5(4) defined "dispute" as meaning a "bona fide suit or arbitration proceedings...". In its present avatar, Section 5(6) excludes the expression "bona fide" which is of significance. Therefore, it is difficult to import the expression "bona fide" into Section 8(2)(a) in order to judge whether a dispute exists or not.

It is clear, therefore, that once the operational creditor has filed an application, which is otherwise complete, the adjudicating authority must reject the application under Section 9(5)(2)(d) if notice of dispute has been received by the operational creditor or there is a record of dispute in the information utility. It is clear that such notice must bring to the notice of the operational creditor the "existence" of a dispute or the fact that a suit or arbitration proceeding relating to a dispute is pending between the parties. Therefore, all that the adjudicating authority is to see at this stage is whether there is a plausible contention which requires further investigation and that the "dispute" is not a patently feeble legal argument or an assertion of fact unsupported by evidence. It is important to separate the grain from the chaff and to reject a spurious defence which is mere bluster. However, in doing so, the Court does not need to be satisfied that the defence is likely to succeed. The Court does not at this stage examine the merits of the dispute except to the extent indicated above. So long as a dispute truly exists in fact and is not spurious, hypothetical or illusory, the adjudicating authority has to reject the application.

On Facts of the Case:

1. According to the respondent, the definition of "dispute" would indicate that since the NDA does not fall within any of the three sub-clauses of Section 5(6), no "dispute" is there on the facts of this case.

The Supreme Court held that:

First and foremost, the definition is an inclusive one, and that the word "includes" substituted the word "means" which occurred in the first Insolvency and Bankruptcy Bill. Secondly, the present is not a case of a suit or arbitration proceeding filed before receipt of notice – Section 5(6) only deals with suits or arbitration proceedings which must "relate to" one of the three sub clauses, either directly or indirectly. A "dispute" is said to exist, so long as there is a real dispute as to payment between the parties that would fall within the inclusive definition contained in Section 5(6). The correspondence between the parties would show that on 30th January, 2015, the appellant clearly informed the respondent that they had displayed the appellant's confidential client information and client campaign information on a public platform which constituted a breach of trust and a breach of the NDA between the parties. They were further told that all amounts that were due to them were withheld till the time the matter is resolved. On 10th February, 2015, the respondent referred to the NDA of 26th December, 2014 and denied that there was a breach of the NDA. The respondent went on to state that the appellant's claim is unfounded and untenable, and that the appellant is trying to avoid its financial obligations, and that a sum of Rs.19,08,202.57 should be paid within one week, failing which the respondent would be forced to explore legal options and initiate legal process for recovery of the said amount. This email was refuted by the appellant by an e-mail dated 26th February, 2015 and the appellant went on to state that it had lost business from various clients as a result of the respondent's breaches. Curiously, after this date, the respondent remained silent, and thereafter, by an e-mail dated 20th June, 2016, the respondent wished to revive business relations and stated that it would like to follow up for payments which are long stuck up. This was followed by an e-mail dated 25th June, 2016 to finalize the time and place for a meeting. On 28th June, 2016, the appellant wrote to the respondent again to finalize the time and place. Apparently, nothing came of the aforesaid e-mails and the appellant then fired the last shot on 19th September, 2016, reiterating that no payments are due as the NDA was breached.

Going by the aforesaid test of "existence of a dispute", it is clear that without going into the merits of the dispute, the appellant has raised a plausible contention requiring further investigation which is not a patently feeble legal argument or an assertion of facts unsupported by evidence. The defence is not spurious, mere bluster, plainly frivolous or vexatious. A dispute does truly exist in fact between the parties, which may or may not ultimately succeed, and the Appellate Tribunal was wholly incorrect in characterizing the defence as vague, got-up and motivated to evade liability.

2. According to the respondent, the breach of the NDA is a claim for unliquidated damages which does not become crystallized until legal proceedings are filed, and none have been filed so far.

The Supreme Court held that:

The period of limitation for filing such proceedings has admittedly not yet elapsed. Further, the appellant has withheld amounts that were due to the respondent under the NDA till the matter is resolved. Admittedly, the matter has never been resolved. Also, the respondent itself has not commenced any legal proceedings after the e-mail dated 30th January, 2015 except for the present insolvency application, which was filed almost 2 years after the said e-mail. All these circumstances go to show that it is right to have the matter tried out in the present case before the axe falls.

Therefore, the appeal was allowed and the judgment of the Appellate Tribunal was set aside.

Case Review: Order dated 24-05-2017 of NCLAT in Kirusa Software Private Ltd. Vs. Mobilox Innovations Private Ltd, Company Appeal (AT) (Insolvency) 6 of 2017, set aside. (Reported in IIIPI Update # 5 Part II July 2017_Case Updates)

NATIONAL COMPANY LAW APPELLATE TRIBUNAL (NCLAT)

Black Pearl Hotels Pvt. Ltd. (Appellant/Operational Creditor)
Vs.
Planet M Retail Ltd. (Respondent/Corporate Debtor)
Date of Order: 17-10-2017

Section 9 of the Insolvency and Bankruptcy Code, 2016 read with Article 137 of the Limitation Act, 1963 – Application for Initiation of Corporate Insolvency Resolution Process by Operational Creditor

The applicant/Operational Creditor filed an application under section 9 of the Code before NCLT, Mumbai Bench on the ground that the respondent/Corporate Debtor (CD) had failed to pay its agreed dues. The Adjudicating Authority by its impugned order dated 4th May 2017 dismissed the application on the ground that the application was barred by limitation.

On appeal, the NCLAT held as follows:

Insolvency and Bankruptcy Code, 2016 has come into force with effect from 1st December, 2016. Therefore, the right to apply under I&B Code accrues only on or after 1st December, 2016 and not before the said date (1st December, 2016). As the right to apply under section 9 of I&B Code accrued to appellant since 1st December, 2016, the application filed much prior to three years, the said application cannot be held to be barred by limitation.

In so far as the application under section 9 of the Arbitration and Conciliation Act, 1996 preferred by appellant, it has been specifically pleaded by the appellant and not disputed by the respondent that the appellant filed an application to withdraw the application under section 9 of the Arbitration Act, expressly reserving liberty to institute fresh proceeding for interim relief. In such circumstances and as no arbitral dispute is pending, the application cannot be rejected.

The Adjudicating Authority, Mumbai Bench was not correct in holding that the application was barred by limitation. For the said reason the order rejecting the application cannot be sustained.

Case Review: Order dated 04.05.2017 passed by the NCLT, Mumbai Bench, in Black Pearl Hotels Pvt. Ltd, Operational Creditor Vs. Planet M. Retail Ltd, Corporate Debtor, (C.P. No.464/I&BP/NCLT/MAH/201), *set aside.*

Hope you find this Update helpful.
Suggestions if any, may be mailed to ipa@icai.in