CASE UPDATES

High Court of Calcutta
Sree Metaliks Limited and Anr. (Corporate Debtor)
Vs.
Union of India & Anr.
Date of Order: 07-04-2017

Section 7 read with section 61 of the Insolvency and Bankruptcy Code, 2016 read with Rule 4 of the Insolvency and Bankruptcy (Application to Adjudication Authority) Rules, 2016 and Section 424 of the Companies Act, 2013 – Initiation of Corporate Insolvency Resolution Process by Financial Creditor

Facts:

An application under section 7 of the Code of 2016 was filed against the first petitioner (Corporate Debtor) before the NCLT Kolkata Bench. According to the first petitioner it had received a notice from a firm of practicing company Secretaries with regard to the filing of the Company Petition, however the notice does not contain any information as to the date of hearing of the company petition. The Corporate Debtor further contended that NCLT had proceeded to admit the company petition without affording any opportunity of hearing to it and therefore NCLT had acted in breach of the principles of natural justice in doing so. The order of NCLT was assailed by the Corporate Debtor before the NCLAT. The Corporate Debtor submitted that it had no objection to the admission of the Insolvency petition but objected to the appointment of the IRP. However, it did not press the point of breach of the principles of natural justice before NCLAT. The NCLAT disposed the appeal and only replaced the IRP appointed by the NCLT.

A writ petition was filed before the Calcutta High Court by the corporate debtor on the ground that Section 7 of the Insolvency and Bankruptcy Code, 2016 (Code of 2016) and the relevant Rules under the Insolvency and Bankruptcy (Application to the Adjudicating Authority) Rules, 2016 are vires as it does not afford any opportunity of hearing to a corporate debtor in a petition filed under Section 7 of the Code of 2016.

Decision:

In the scheme of the Code of 2016, an application under Section 7 of the Code of 2016 is to be first made before the NCLT. An appeal of the order of NCLT will lie before the NCLAT. NCLT and NCLAT are constituted under the provisions of the Companies Act, 2013 (Act, 2013). The procedure before the NCLT and the NCLAT is guided by Section 424 of the Companies Act, 2013.

Section 424 of the Companies Act, 2013 requires the NCLT and NCLAT to adhere to the principles of the natural justice above anything else. It also allows the NCLT and NCLAT the power to regulate their own procedure. Fretters of the Code of Civil Procedure, 1908 does not bind it. However, it is required to apply its principles. Principles of natural justice require an authority to hear the other party. In an application under Section 7 of the Code of 2016, the financial creditor is the applicant while the corporate debtor is the respondent. A proceeding for declaration of insolvency of a company has drastic consequences for a company. Such proceeding may end up in its liquidation. A person cannot be condemned unheard. Where a statute is silent on the right of hearing and it does not in express terms, oust the principles of natural justice, the same can and should be read into in. When the NCLT receives an application under Section 7 of the Code of 2016, therefore, it must afford a reasonable opportunity of hearing to the corporate debtor as Section 424 of the Companies Act, 2013 mandates it to ascertain the existence of default as claimed by the financial creditor in the application. The NCLT is, therefore, obliged to afford a reasonable opportunity to the financial debtor to contest such claim of default by filing a written objection or any other written document as the NCLT may direct and provide a reasonable opportunity of hearing to the corporate debtor prior to admitting the petition filed under Section 7 of the Code of 2016. Section 7(4) of the Code of 2016 requires the NCLT to ascertain the default of the corporate debtor. Such ascertainment of default must necessarily involve the consideration of the documentary claim of the financial creditor. This statutory requirement of ascertainment of default brings within its wake the extension of a reasonable opportunity to the corporate debtor to substantiate by document or otherwise, that there does not exist a default as claimed against it. The proceedings before the NCLT are adversarial in nature. Both the sides are, therefore, entitled to a reasonable opportunity of hearing.

National Company Law Appellate Tribunal (NCLAT)
Kirusa Software Private Ltd. (Appellant/ Operational Creditor)
Vs.
Mobilox Innovations Private Ltd. (Respondents/ Corporate Debtor)
Date of Order: 24-05-2017

Section 9 read with sections 5, 7 & 8 of the Insolvency and Bankruptcy Code, 2016 – Application for Initiation of Corporate Insolvency Resolution Process by Operational Creditor

Facts:

The only question arises for considered in this appeal is what does "dispute" and "existence of dispute" means for the purpose of determination of a petition under section 9 of the 'I & B Code'?

Decision:

In sub-section (1) of Section 8 of the 'I & B Code', though the word "may" has been used, but in the context of Section 8 and Section 9 reading as a whole, an 'Operational Creditor,' on occurrence of a default, is required to deliver a notice of demand of unpaid debt or get copy of the invoice demanding payment of the defaulted amount served on the corporate debtor. This is the condition precedent under Section 8 and 9 of the 'I & B Code', before making an application to the Adjudicating Authority.

Thus it is evident from Section 9 of the 'I& B Code' that the Adjudicating Authority has to, within fourteen days of the receipt of the application under sub-section (2), either admit or reject the application.

Section 9 has two-fold situations in so far as notice of dispute is concerned. As per sub-section (5)(1)(d) of Section 9, the Adjudicating Authority can admit the application in case no notice raising the dispute is received by the operational creditor (as verified by the operational creditor on affidavit) and there is no record of a dispute is with the information utility.

On the other hand, sub-section (5)(ii) of Section 9 mandates the Adjudicating Authority to reject the application if the operational creditor has received notice of dispute from the corporate debtor. Section 9 thus makes it distinct from Section 7. While in Section 7, occurrence of default has to be ascertained and satisfaction recorded by the Adjudicating Authority, there no similar provision under Sections 9.

Under Section 7 neither notice of demand nor a notice of dispute is relevant whereas under Sections 8 and 9 notice of demand and notice of dispute become relevant both for the purposes of admission as well as for and rejection.

Though the words 'prima facie' are missing in Sections 8 and 9 of the Code, yet the Adjudicating Authority would examine whether notice of dispute in fact raises the dispute and that too within the parameters of two definitions - 'debt' and 'default' and then it has to reject the application if it apparently finds that the notice of dispute does really raise a dispute and no other factual ascertainment is required. On the other hand, if the Adjudicating Authority finds that the notice of dispute lacks in particulars or does not raise a dispute, it may admit the application but in either case, there is neither an ascertainment of the dispute, nor satisfaction of the Adjudicating Authority.

Sub Section (6) of Section 5 defines "dispute", to include, unless the context otherwise requires, a dispute pending in any suit or arbitration proceedings relating to:

(a) existence of amount of the debt;
(b) quality of good or service;
(c) breach of a representation or warranty.

The definition of "dispute" is "inclusive" and not "exhaustive". The same has to be given wide meaning provided it is relatable to the existence of the amount of the debt, quality of good or service or breach of a representation or warranty.

Once the term "dispute" is given its natural and ordinary meaning, upon reading of the Code as a whole, the width of "dispute" should cover all disputes on debt, default etc. and not be limited to only two ways of disputing a demand made by the operational creditor, i.e. either by showing a record of pending suit or by showing a record of a pending arbitration.

The intent of the Legislature, as evident from the definition of the term "dispute", is that it wanted the same to be illustrative (and not exhaustive). If the intent of the Legislature was that a demand by an operational creditor can be disputed only by showing a record of a suit or arbitration proceeding, the definition of dispute would have simply said dispute means a dispute pending in Arbitration or a suit.

The statutory requirement in sub-section (2) of Section 8 of the 'I & B Code' is that the dispute has to be brought to the notice of the Operational Creditor. The two comes post the word 'dispute' (if any) have been added as a matter of convenience and/or to give meaningfulness to sub-section (2) of Section 8 of the 'I & B Code'. Without going into the grammar and punctuation being hapless victim of pace of life, if one discovers the true meaning of sub-section (2)(a) of Section 8 of the 'I & B Code', having regard to the context of Sections 8 and 9 of the Code, it emerges both from the object and purpose of the 'I & B Code' and the context in which the expression is used, that disputes raised in the notice sent by the corporate debtor to the Operational Creditor would get covered within sub-section (2) of Section 8 of the 'I & B Code'.

The true meaning of sub-section (2)(a) of Section 8 read with sub-section (6) of Section 5 of the 'I & B Code' clearly brings out the intent of the Code, namely the Corporate Debtor must raise a dispute with sufficient particulars. And in case a dispute is being raised by simply showing a record of dispute in a pending arbitration or suit, the dispute must also be relatable to the three conditions provided under sub-section (6) of Section 5 (a)-(c) only. The words 'and record of the pendency of the suit or arbitration proceedings' under sub-section (2)(a) of Section 8 also make the intent of the Legislature clear that disputes in a pending suit or arbitration proceeding are such disputes which satisfy the test of subsection (6) of Section 5 of the 'I & B Code' and that such disputes are within the ambit of the expression, 'dispute, if any'. The record of suit or arbitration proceeding is required to demonstrate the same, being pending prior to the notice of demand under sub-section 8 of the 'I & B Code'.

It is a fundamental principle of law that multiplicity of proceedings is required to be avoided. Therefore, if disputes under sub-section (2)(a) of Section 8 read with sub-section (6) of Section 5 of the 'I & B Code' are confined to a dispute in a pending suit and arbitration in relation to the three classes under subsection (6) of Section 5 of the 'I & B Code', it would violate the definition of operational debt under sub-section (21) of Section 3 of the 'I & B Code' and would become inconsistent thereto, and would bar Operational Creditor from invoking Sections 8 and 9 of the Code.

Sub-section (6) of Section 5 read with sub-section (2)(a) of Section 8 also cannot be confined to pending arbitration or a civil suit. It must include disputes pending before every judicial authority including mediation, conciliation etc. as long there are disputes as to existence of debt or default etc., it would satisfy subsection (2) of Section 8 of the 'I & B Code'.

Therefore, as per sub-section (2) of Section 8 of the 'I & B Code', there are two ways in which a demand of an Operational Creditor can be disputed:

i. By bringing to the notice of an operational creditor, 'existence of a dispute'. In this case, the notice of dispute will bring to the notice of the creditor, an 'existence of a dispute' under the Code. This would mean disputes as to existence of debt or default etc.; or

ii. By simply bringing to the notice of an operational creditor, record of the pendency of a suit or arbitral proceedings in relation to a dispute. In this case, the dispute in the suit/arbitral proceeding should relate to matters (a)-(c) in sub-section (6) of Section 5 and in this case, showing a record of pendency of a suit or arbitral proceedings on a dispute is enough and to intent of the Legislature is clear, i.e. once the dispute (on matters relating to 3 classes in sub-section (6) of Section 5 of the 'I & B Code') is pending adjudication, that in itself would bring it within the ambit of sub-section (6) of Section 5 of the 'I & B Code'.

Thus the definition of 'dispute', 'operational debt' is read together for the purpose of Section 9 is clear that the intention of legislature to lay down the nature of 'dispute' has not been limited to suit or arbitration proceedings pending but includes other proceedings "if any".

Therefore, it is clear that for the purpose of sub-section (2) of Section 8 and Section 9 a 'dispute' must be capable of being discerned from notice of corporate debtor and the meaning of "existence" a "dispute, if any", must be understood in the context.
Mere raising a dispute for the sake of dispute, unrelated or related to clause (a) or (b) or (c) of Subsection (6) of Section 5, if not raised prior to application and not pending before any competent court of law or authority cannot be relied upon to hold that there is a 'dispute' raised by the corporate debtor. The scope of existence of 'dispute', if any, which includes pending suits and arbitration proceedings cannot be limited and confined to suit and arbitration proceedings only. It includes any other dispute raised prior to Section 8 in this in relation to clause (a) or (b) or (c) of sub-section (6) of Section 5. It must be raised in a court of law or authority and proposed to be moved before the court of law or authority and not any got up or malafide dispute just to stall the insolvency resolution process.

While sub-section (2) of Section 8 deals with "existence of a dispute", sub-section (5) of Section 9 does not confer any discretion on adjudicating authority to verify adequacy of the dispute. It prohibits the adjudicating authority from proceeding further if there is a genuine dispute raised before any court of law or authority or pending in a court of law or authority including suit and arbitration proceedings. Mere a dispute giving a colour of genuine dispute or illusory, raised for the first time while replying to the notice under Section 8 cannot be a tool to reject an application under Section 9 if the operational creditor otherwise satisfies the adjudicating authority that there is a debt and there is a default on the part of the corporate debtor.

The onus to prove that there is no default or debt or that there is a dispute pending consideration before a court of law or adjudicating authority shift from creditor to debtor and operational creditor to corporate debtor.

The dispute as defined in sub-section (6) of Section 5 cannot be limited to a pending proceedings or "lis", within the limited ambit of suit or arbitration proceedings, the word 'includes' ought to be read as "means and includes" including the proceedings initiated or pending before consumer court, tribunal, labour court or mediation, conciliation etc. If any action is taken by corporate debtor under any act or law including while replying to a notice under section 80 of CPC, 1908 or to a notice issued under Section 433 of the Companies Act or Section 59 of the Sales and Goods Act or regarding quality of goods or services provided by 'operational creditor' will come within the ambit of dispute, raised and pending within the meaning of sub-section (6) of Section 5 read with sub-section (2) of Section 8 of I&B code, 2016.
From the reply of the respondent-corporate debtor to the notice under section 8 of the code it could be seen that it has not raised any dispute within the meaning of sub-section (6) of Section 5 or sub-section (2) of Section 8 of I&B Code, 2016 and in that view of the matter, merely on some or other account the respondent has disputed to pay the amount, cannot be termed to be dispute to reject the application under Section 9 of the I&B Code, 2016 as was preferred by appellant-operational creditor.

The requirement under sub-section (3)(c) of Section 9 while independent operational creditor to submit a certificate from the financial institution as defined in sub-section (4) of section 3 including Scheduled Bank and public financial institution and like which is a safeguard prevent the operational creditor to bring a non-existence or baseless claim. Similarly the adjudicating authority is required to examine before admitting or rejecting an application under Section 9 whether the 'dispute' raised by corporate debtor qualify as a 'dispute' as defined under sub-section (6) of Section 5 and whether notice of dispute given by the corporate debtor fulfilling the conditions stipulated in sub-section (2) of Section 8 of I&B Code, 2016.

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 constitute and as to what constitute 'dispute' in relation to services provided by operational creditor then would have come to a conclusion that condition of demand notice under subsection (2) of Section 8 has not been fulfilled by the corporate debtor and the defence claiming dispute was not only vague, got up and motivated to evade the liability.

Case Review:

Order dated 27th January, 2017
passed by NCLT, Mumbai Bench, in
Kirusa Software Private Ltd.
Vs.
Mobilox innovations Private Ltd.
(C.P. No.01/I&BP/NCLT/MAH/2017), set aside.