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A GALORE OF DISPUTES - MOBILOX INNOVATIONS PRIVATE LIMITED VS. KIRUSA SOFTWARE PVT. LTD.

INTERPRETATION OF 'DISPUTE' AND 'EXISTENCE OF DISPUTE' IN INSOLVENCY AND BANKRUPTCY CODE

INTRODUCTION

The Apex Court in “**Mobilox Innovations Private Limited -versus- Kirusa Software Private Limited**” [1](for short “**Mobilox Case**”) vide its judgment dated 21.09.2017, has finally settled the widely debated issue of what constitutes “existence of a dispute” in the context of applications filed by operational creditors for initiation of corporate insolvency resolution process (for short “**CIRP**”) of corporate debtors under the Insolvency and Bankruptcy Code, 2016 (for short “**IBC**”).

FACTS/ BACKGROUND

The facts of the Mobilox Case are briefly summarized below:

- (i) Mobilox Innovations Private Limited (for short “**MIPL**”) was engaged by Star TV for conducting tele-voting for the program Nach Baliye on Star TV. MIPL in turn sub-contracted the above work to Kirusa Software Private Limited (for short “**KSPL**”).
- (ii) That a Non-Disclosure Agreement (for short “**NDA**”) was executed between the MIPL and KSPL on 26.12.2014 with effect from 01.11.2013.
- (iii) KSPL (Operational Creditor) provided the requisite services to MIPL (Corporate Debtor) and raised its invoices. MIPL vide its correspondence dated 30.01.2015, however refused to pay the invoices raised by KSPL on the ground that KSPL had breached the terms and conditions of the NDA.
- (iv) Thereafter, KSPL on 23.12.2016, issued a demand notice to MIPL as an operational creditor under section 8(1) of the IBC, demanding payment of Rs. 20,08,202.55/- for the services rendered to MIPL.
- (v) That MIPL vide an e-mail dated 27.12.2016 responded to the demand notice of KSPL, and stated

that there exists a serious and bona fide dispute between KSPL and MIPL regarding the debt claim and alleged breach of the terms of NDA.

(vi) Thereafter, KSPL on 30.12.2016 filed an application before the Hon’ble National Company Law Tribunal [2] (for short “**NCLT**”) under Section 8 and 9 of the IBC for initiation of CIRP against MIPL, stating that an operational debt of Rs. 20,08,202.55/- was owed to KSPL (Operational Creditor) by MIPL (Corporate Debtor). The NCLT vide its order dated 27.01.2017 rejected the application of KSPL on the ground that MIPL vide its e-mail dated 27.12.2016 disputed the debt claim raised by KSPL, therefore the application for initiation of CIRP by KSPL against MIPL is hit by Section 9(5)(ii)(d) of the IBC.

(vii) An appeal was filed by KSPL before the Hon’ble National Company Law Appellate Tribunal (for short “**NCLAT**”) challenging the order dated 27.01.2017 of the NCLT. The Hon’ble NCLAT vide its order dated 24.05.2017 allowed the appeal of KSPL and held that the condition of sub-section 8(2) of the IBC is not fulfilled by MIPL and the defense claiming dispute of the operational debt by the MIPL was not only vague, got up and motivated to evade the liability.

(viii) Aggrieved by the order of the Hon’ble NCLAT, MIPL filed an appeal before the Apex Court.

ISSUE

What is the scope and ambit of the terms “dispute” as defined in Section 5(6) of the IBC and “existence of dispute” as mentioned in Section 8(2)(a) of the IBC for determining the maintainability of an application/petition filed by the operational creditors for initiation of CIRP against corporate debtor under Section 9 of the IBC?



Pratibha

B.A.LL.B from
Campus Law Centre
University of Delhi

Expertise:

Corporate, Compliances
and Litigation

✉ pratibha.p@mcolegals.in



Paramita Banerjee

B.A. LLB from Christ University
School of Law, Bangalore

Expertise:

Company laws,
Arbitration and Litigation

✉ paramita.b@mcolegals.in

[1] 7 SCC OnLine SC 1154

[2] 2017 SCC OnLine NCLT 314

OBSERVATION OF THE APEX COURT

As the Mobilox Case raises question as to the triggering of the IBC when it comes to operational debts owed to operational creditors, it is important to understand the object, legislative intent, important provisions relating to insolvency resolution by operational creditors.

(i) OBJECT OF THE IBC

The main object of the IBC is to consolidate and amend the laws relating to reorganization and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximization of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interest of all stakeholders adequately.

(ii) CIRP

Part II of the IBC deals with matter relating to insolvency resolution and liquidation for corporate debtors where the minimum amount of the default is one Lakh Rupee. Default means non-repayment of debt when whole or any part or installment of the amount of debt has become due and payable and not repaid by the corporate debtor. The Apex Court observed that early recognition of financial distress is very important for timely resolution of insolvency and one of the objects of IBC is to initiate the CIRP at an early stage when the corporate debtor shows early signs of financial distress rather than at the point where it would be difficult to revive it effectively.

(a) Who may trigger CIRP

Where any corporate debtor commits a default, a financial creditor, an operational creditor or the corporate debtor itself may initiate CIRP. Thus, IBC differentiates two categories of creditors:

- Financial creditors: Financial creditors are the creditors to whom corporate debtor owes financial debt, such as loan or a debt security
- Operational Creditors: Operational creditors are the creditors to whom corporate debtor owes an operational debt (operational debt means a claim in respect of the provision of goods or services including employment or a debt in respect of payment of dues to the Central/State Government or local authorities).

(b) How CIRP can be triggered by an operational creditor

- The procedure for initiation of the CIRP by an operational creditor differs from the procedure applicable to financial creditors, as operational debts (such as trade debts, salary or wage claims) tend to be of small amount or are recurring in nature as compared to financial debts.
- Section 8 of the IBC lays down the procedure for initiation of the CIRP by an operational creditor against the corporate debtor and Section 8(1) of the IBC states that the operational creditor on the occurrence of the default has to deliver a demand notice or a copy of an invoice to the corporate debtor demanding payment of the debt in default.
- As per Section 8(2) of the IBC, the corporate debtor has 10 days from the receipt of the invoice or demand notice from operational creditor as mentioned in Section 8(1), to inform the operational creditor of the (a) “**existence of a dispute**, if any, and record of the pendency of the suit or arbitration proceeding” filed before the receipt of the notice or invoice in relation to such dispute (Section 8(2)(a)) or (b) repayment of the operational debt.

- The object of the period of 10 days as mentioned in section 8(2) of the IBC to corporate debtor is to inform the operational creditor of the existence of a dispute regarding the debt claim or the repayment of the debts to ensure that operational creditors, whose debt claims are usually smaller, are not able to put the corporate debtor into the CIRP prematurely or initiate the CIRP for extraneous consideration.
- Interpretation of Section 8(2)(a) of the IBC: Section 8(2)(a) reads as follows “existence of a dispute, if any, **and** record of the pendency of the suit or arbitration proceedings filed before the receipt of such notice or invoice in relation to such dispute”. The Apex Court observed that the word **and** occurring in Section 8(2)(a) of the IBC must be read as **or** in order to further the object of the IBC and to avoid an anomalous situation. If section 8(2)(a) is read as **and**, disputes would only stave off the bankruptcy process if they are pending in a suit or arbitration proceedings and not otherwise. This would lead to a great hardship if a dispute may arise a few days before the triggering of the insolvency process, in which case, though a dispute may exist, there is no time to reach an arbitral tribunal or court. The Apex Court after considering the object of the IBC held that one of the objects of the IBC qua operational debts is to ensure that the amount of such debts, which is usually of smaller than that of financial debts, does not enable operational creditor to put the corporate debtor into the CIRP process prematurely or initiate the CIRP for extraneous consideration. It is for this reason that it is enough that a dispute exist between the operational creditor and corporate debtor, and thus, word **and** occurring in Section 8(2)(a) must be read as **or**.

(iii) MEANING OF ‘DISPUTE’ AND ‘EXISTENCE OF DISPUTE’

(a) Dispute

- It is important to understand the definition of ‘dispute’ and existence of dispute to understand the Mobilox Case. The Apex Court to interpret the term ‘dispute’ compared the definition of dispute in Insolvency and Bankruptcy Bill, 2015 (for short ‘**Bill 2015**’) and the definition of the dispute in IBC.

The Bill 2015 defined the term ‘dispute’ as follows:

“dispute **means** a **bonafide** suit or arbitration proceeding regarding (a) the existence or the amount of debt; (b) the quality of good or service or (c) the breach of a representation of warranty.”

However, the above definition of dispute underwent few changes and the dispute as defined in Section 5(6) of the IBC is as follows:

“*dispute*” **includes** a suit or arbitration proceedings relating to-

- (a) The existence of the amount of debt,
- (b) The quality of goods and services
- (c) The breach of a representation or warranty”

- The Apex Court observed that as the word ‘**bona fide**’ has been deleted and the word ‘**means**’ has been substituted by ‘**includes**’ in the new definition of dispute (Section 5(6)), hence, the definition of the dispute is an inclusive definition. The Apex Court has expanded the definition of Section 5(6) of the IBC and is not restricted to pending suits and arbitration. The Apex Court further held that as the word

[3] 2017 SCC OnLine NCLAT 72

bonafide has been removed from the definition of the IBC, 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.

(b) Question of Admissibility of a CIRP

- Section 9 of the IBC states that if on expiry of the period of 10 days from the date of receipt of the invoice or demand notice as stated in Section 8 of the IBC, if the operational creditor does not receive either the payment of the debt or a notice of existence of dispute in relation to the debt claim from the corporate debtor, the operational creditor can file an application with the adjudicating authority for initiating the CIRP in respect of the corporate debtor. The adjudicating authority within 14 days from the receipt of the application by operation creditor is satisfied as to the (a) existence of a default, and (b) the other criteria laid down in Section 9(5) of the IBC being met, it shall admit the application.
- The Apex Court held that the adjudicating authority while examining an application for initiation of CIRP by operational creditor must follow the mandate of Section 9 and in particular the mandate of Section 9(5) of the IBC and admit or reject the application as the case may be depending upon the factors mentioned in Section 9(5) of the IBC. Therefore, the adjudicating authority, when examining an application under section 9 of the IBC will have to determine :
 - (i) Whether there is an operational debt as defined exceeding Rs. 1 Lakh?
 - (ii) Whether the documentary evidence furnished with the application for initiation of CIRP by operational creditor shows that the operational debt is due and payable and has not yet been paid by the corporate debtor? and
 - (iii) Whether there is existence of 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?

The Apex Court was of the view that if any of the aforesaid conditions was lacking the application of the operational creditor for initiation of CIRP against the corporate debtor would have to be rejected by the adjudicating authority.

- The Apex Court observed that it is important that the existence of dispute or the suit or arbitration proceeding regarding the unpaid debt between the parties (that is operational creditor and corporate debtor) must be pre-existing-i.e. it must exist before the receipt of demand notice or invoice as stated in Section 8(1) of the IBC.

(c) Existence of dispute –Real or illusory

- The Apex Court after referring to various judgment of the Apex Court and relying on the dictionary meaning of 'existence' which means reality as opposed to appearance and held that the adjudicating authority while determining the existence of a dispute does not have to examine the merits of the dispute but only has to see that whether a dispute truly exist in fact and is not spurious, hypothetical or illusory. So long as a dispute between the parties truly exist in fact and is not spurious, mere bluster, plainly frivolous or vexatious, the adjudicating authority has to reject the application of the operational creditor regarding initiation of CIRP in relation to corporate debtors.

DECISION

The Apex Court observed that the demand notice issued by KSPL regarding the unpaid operational debt under section 8 was disputed by MIPL in its reply dated 27.12.2016. The Apex Court allowing the appeal of MIPL observed that a dispute is said to exist, so long as there is a real dispute as to the payment of debt between the parties and would fall within the definition of dispute contained in section 5(6) of the IBC. The Apex Court applied the test of existence of dispute and held that without getting into the merits of the case MIPL had raised a dispute regarding the debt claim which cannot be considered as spurious, mere bluster, plainly frivolous or vexatious and therefore, Hon'ble NCLAT was wholly incorrect in characterizing the dispute raised by MIPL as vague, got-up and motivated to evade liability.