

10<sup>th</sup> February, 2023

# PROCEEDINGS UNDER SECTION 138 OF NI ACT – UNDERSTANDING DEBT UNDER IBC

## A. “DISPUTE” UNDER INSOLVENCY & BANKRUPTCY CODE

A lawsuit or arbitration hearing involving the existence of debt; the standard of the product or service and/or a representation or warranty that has been breached is a "dispute". The definition of the disputes as given under Section 5(6) of Insolvency and Bankruptcy Code, 2016 (Code) states that the “dispute includes a suit or arbitration proceedings relating to- (a) the existence of the amount of debt; (b) the quality of goods or service; or (c) the breach of a representation or warranty.”

There have been numerous instances where courts and tribunals were to decide and define what will be considered as a prima facie conflict due to the concept of dispute and the persistent uncertainty as to what constitutes dispute. It is required to be emphasised that the word "includes" has a broad definition and can refer to a variety of things, not just specific problems.

In **Innoventive Industries v. ICICI Bank [(2018) 1 SCC 407]**, the Apex Court held that "The corporate debtor is permitted to argue that a default has not occurred in the sense that the "debt," which may also include a disputed claim, is not due, at the stage of Section 7(5), where the adjudicating authority is to be convinced that a default has occurred. If a debt is not legally or factually payable, it might not be due." As a result, a Corporate Debtor may also contest the existence of debt. The Ld. NCLAT gave a liberal reading of the terms "dispute" and "existence of dispute" in **Kirusa Software Pvt. Ltd. v. Mobilox Innovations Pvt. Ltd. (Company Appeal (AT) (Insolvency) 6 of 2017)** and held that a dispute between the parties did not have to be ongoing at the time of the notice of demand; it might instead be brought up later. It also made clear that the Adjudicating Authority just needs a proof that there is a legitimate disagreement. In the case of **A.D.**

**Electro Steel Co. Pvt. Ltd. & Anr. Vs. Anil Steels [Company Appeal (AT) (Insolvency) No. 194 of 2017]**, the Ld. NCLAT applied the abovementioned case and explained that a demand notice of an outstanding operational debt or a copy of an invoice requesting payment of the amount in question must be given in the required form to an operational creditor.

## B. DEFINING PRE-EXISTING DISPUTE

The pre-existing issue that could be used as justification to deny the initiation of Corporate Insolvency process under Section 9 of the Code must actually be a conflict or controversy. According to Section 8(2) of the Code, such a conflict of claims or rights should be clear from the reply to the Demand Notice. In essence, this means that there must be a legitimate, substantial issue before the Corporate Debtor can raise any such arguments.

## C. INSOLVENCY & BANKRUPTCY CODE VERSUS NEGOTIABLE INSTRUMENTS ACT

In **Shah Brothers Ispat (P) Ltd. v. P. Mohanraj [(2021) 6 SCC 258]**, the Supreme Court ruled that the moratorium under Section 14 of the IBC applies to proceedings under NI Act since the same is a proceeding in a court of law about a transaction relating to a debt owed by the corporate debtor. The Hon'ble Supreme Court while elaborating the expression under Section 14 of the Code, i.e., "proceedings against the corporate debtor, including execution of any judgement, decision, or order in any court of law, tribunal, arbitration panel, or other authority" held that Section 14 includes proceedings before a Magistrate under Section 138 of the NI Act.

In the case of **'Vibrus Homes Pvt. Ltd. v. Ashimara Housing Pvt. Ltd.' [Company Appeal (AT) (Insolvency) No. 80 of 2022; dated 22.04.2022]**, the corporate debtor argued that there was an existing dispute that had been brought to light by the issuance of the legal notice required by Section 138 of the N.I.



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Act. Per contra, it was submitted by operational creditor that Notice under NI Act issued under NI Act cannot be considered as a dispute. Therefore, the arguments of the Corporate debtor does not hold any ground. The Ld. NCLAT while recording the submission of Corporate Debtor that the amount had been received and returned back, held that the an interest-free security deposit received in connection with lease or licence agreement involving real property in essence qualifies as an operational debt under the Code. Moreover, the Ld. NCLAT held that the issuance of legal notice under NI act does not necessitate preexisting dispute.

In **Sudhi Sachdev v. APPL Industries Ltd., [2018 SCC OnLine NCLAT 775]**, the question raised was whether there was an existence of dispute in view of the fact that the Operational Creditor had instituted cases under Section 138/441 of NI Act which were pending in the court of Metropolitan Magistrate, Gurgaon. The Ld. NCLAT reiterating its finding held that cases pending under Section 138/441 of the NI Act actually amounted to an admission of debt rather than the presence of a disagreement/ dispute and the pendency of the cases does not constitute a dispute under the Code.

#### **D. CONCLUSION**

The Code clearly defines the word "dispute" with regard to operational debts and enables Corporate Debtors the opportunity to draw attention to such dispute. These disagreements need not only be ones that are brought up in court cases or arbitration hearings. When determining whether a conflict exists, the adjudicating authority must only consider whether the dispute is real and not just a mirage.

According to the Ld. NCLAT, the existence of a dispute with regard to the IBC proceedings cannot be inferred from the fact that NI Act proceedings are still pending. However, what may be confusing for situations in the future would necessarily be the point of contention in respect to the overriding effect of the Code with regard to NI Act. Moreover, the proceedings in NI Act are criminal in nature, with directors also being arrayed as party to such proceedings, thus it is imperative that the proceedings under NI Act should continue even if the Corporate Debtor is into CIRP proceedings. It would not be abrupt to mention that the initiation of proceedings under Section 138 of the NI Act does in fact constitute admission of debt, since the same is filed only when the Corporate Debtor defaults in payment and cheques is bounced consequently resulting in proceedings under the NI Act.