

Insolvency and Bankruptcy Hotline

March 04, 2019

CLAIMING DAMAGES? DON'T GO UNDER IBC, SAYS NCLT

- NCLT Imposes penalty on the Petitioner for attempting to initiate CIRP based on incorrect facts and false information
- Holds that a claim not adjudicated upon by a competent authority in law cannot be an "operational debt" under IBC.
- Claim related to non-payment of advance money is not covered under IBC.

INTRODUCTION

The National Company Law Tribunal, Mumbai ("NCLT") in a recent case in *TATA Chemicals Limited v/s. Raj Process Equipment's and Systems Private Limited*¹ dismissed a petition of Tata Chemicals ("Petitioner") filed under Section 9 of the Insolvency & Bankruptcy Code, 2016 ("IBC") and imposed costs of INR 10 lakhs (USD 14,000 approximately) upon the Petitioner, for its attempts to initiate a Corporate Insolvency Resolution Process ("CIRP") against the corporate debtor on ulterior motives.

FACTUAL MATRIX

The Petitioner had approached Raj Process Equipment's & Systems Private Ltd. ("Corporate Debtor") for the designing, building, transporting, erecting and commissioning of certain industrial equipment. A purchase order was raised by the Petitioner for the said equipment, for which the Petitioner made an advance payment of ₹4,40,000 ("Advance Amount").

The Petitioner argued that despite repeated reminders, Corporate Debtor failed to deliver the equipment on the scheduled delivery date. The Respondent submitted that delays caused were *inter alia*, due to frequent changes in specifications and rectifications to the drawings suggested by the Petitioner,

The Petitioner proceeded to terminate the purchase order and demanded refund of the Advance Amount, claiming an additional amount of INR 9,15,00,000/- towards financial loss ("Financial Damages"). Further, the Petitioner claimed interest of INR 70,84,311/- and INR 34,066/- respectively.

The Petitioner filed the petition under Section 9 of the IBC, claimed that the actual principal amount due is INR 9,19,40,000 ("Principal Amount").

JUDGMENT

The Claim of Financial Damages does not qualify as Operational debt

The NCLT observed that Section 73 of the Indian Contract Act provides that when a contract has been broken, the party who suffers such breach is entitled to receive, from the party, who has broken the contract, compensation for any loss or damage caused to him and which naturally arose in the usual course of things from such breach, or which the parties knew, when they made the contract, to be likely to result from the breach of it. Further, when an obligation resembling those created by contract has been incurred and not discharged, the injured party is entitled to receive the same compensation from the party in default, as if such person had contracted to discharge it, and had broken his contract, it observed. Accordingly, the NCLT found that in the present case, the Petitioner has raised claims of INR 5,00,000 per day for loss of production, which is not only in nature of consequential damages, but also completely arbitrary and baseless, and which cannot be relied upon in absence of adjudication

Placing reliance in the cases of *E-City Media Private Limited vs Sadhtra Retail Limited*² and in *Union of India vs Raman Iron Foundry*³, the NCLT observed that the claim regarding Financial Damages was without any adjudication and therefore not an 'operational debt' as defined under the IBC. It held that a claim for damages does not become operational debt until the liability is adjudicated upon and damages are assessed by a competent authority in law.

Petitioner is not an "operational creditor"

The NCLT observed that no goods or services were provided by the Corporate Debtor to the Petitioner and that, in fact, it is the Corporate Debtor who is the vendor to whom the Petitioner hasn't made payments for goods. Since the Claim of the Petitioner was not based on any goods or services actually supplied, it would not fall under the definition of operational debt. The NCLT thus held that given the circumstances, the Petitioner would not fall under the definition of 'Operational Creditor' under the IBC.

Insolvency petition filed with malafide intentions

The court observed that the Principal Amount, as stated in the petition and affidavit, was not even quantified at the

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time of filing and was 209 times the actual amount advanced by the Petitioner to the Corporate Debtor. This, the NCLT observed, only showed that the petition was filed basis false information.

The Petitioner had also filed an affidavit certifying the contents of the petition. This, the NCLT found, clearly showed that the Petitioner had filed the petition for initiation of CIRP fraudulently and with a malicious intent for any purpose other than for the resolution of insolvency and therefore invoked Section 65 of the IBC.

In light of the above, and without going into the merits, the NCLT held that the Petition has been filed with ulterior motive to get insolvency petition admitted which comes under purview of Section 65⁴ of the IBC, consequently dismissing the Petition and imposing costs of INR 10,00,000 on the Petitioner, to be paid to the "Prime Minister National Relief Fund".

CONCLUSION

In this judgment, the NCLT has reaffirmed the main purpose of IBC which is the resolution of distressed companies and not to provide parties a weapon to arm twist an entity into succumbing to claims, which may not even have been adjudicated upon. This judgement clarifies that a claim for damages does not become operational debt until the liability is adjudicated upon and damages are assessed by a competent authority. Further, this decision should deter parties from filing petitions without adequately and accurately quantifying their claims.

When it comes to filing a petition under Section 9 of the IBC, parties should be careful to ensure that the claim for operational debt due made therein is undisputed, crystallized, payable and not something which requires further adjudication by a competent authority, or else penalties may be imposed upon them under Section 65 of the IBC.

– Siddharth Ratho & Sahil Kanuga

You can direct your queries or comments to the authors

¹ CP 21/I&BP/NCLT/MAH/2018

² CP No.367 of 2009

³ (1974 AIR 1265, 1974 SCR (3) 556)

⁴ Section 65. (1) If, any person initiates the insolvency resolution process or liquidation proceedings fraudulently or with malicious intent for any purpose other than for the resolution of insolvency, or liquidation, as the case may be, the Adjudicating Authority may impose upon such person a penalty which shall not be less than one lakh rupees, but may extend to one crore rupees. (2) If, any person initiates voluntary liquidation proceedings with the intent to defraud any person, the Adjudicating Authority may impose upon such person a penalty which shall not be less than one lakh rupees but may extend to one crore rupees

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