

# Insolvency and Bankruptcy Hotline

October 04, 2017

## SUPREME COURT UNRAVELS THE DISPUTED DEBT CONUNDRUM UNDER THE BANKRUPTCY CODE

Supreme Court:

- Acknowledges that disputes may exist, without necessarily being escalated to the court/arbitration;
- So long as a dispute exists in fact and is not spurious, hypothetical or illusory, insolvency application is liable to be rejected;
- Adjudicating authority has only to see whether there is a plausible contention which requires further investigation, without going into the merits of the dispute;

### INTRODUCTION

The Supreme Court of India (“**Supreme Court**”) in *Mobilox Innovations Private Limited (“Mobilox”) Vs. Kirusa Software Private Limited (“Kirusa”)*<sup>1</sup> has finally settled the issue regarding the interpretation of ‘dispute in existence’ under the Insolvency and Bankruptcy Code, 2016 (“**the Code**”) providing much relief and clarity to operational debtors who may have a genuine dispute regarding the debt, but may not have yet initiated legal proceedings. The Court has acknowledged the fact that situations may exist where a debtor company may have a dispute *qua* an operational creditor, which it may have chosen not to escalate to a court/arbitral tribunal.

### BRIEF FACTS

Kirusa issued a demand notice to Mobilox as an Operational Creditor under the Code, demanding payment of certain dues. Mobilox issued a reply to the demand notice (“**Mobilox Reply**”) *inter alia* stating that there exists certain serious and *bona fide* disputes between the parties and alleged a breach of the terms of a non-disclosure agreement by Kirusa. Kirusa filed an application under Section 9 of the Code (“**Application**”) before the National Company Law Tribunal, Mumbai (“**NCLT**”) for initiation of the corporate insolvency resolution process (“**CIRP**”) against Mobilox. This was dismissed by the NCLT, which expanded the scope of an ‘existing dispute’ under the Code to hold that a valid notice of dispute had been issued by Mobilox.

Kirusa filed an appeal before the National Company Law Appellate Tribunal (“**NCLAT**”), which allowed Kirusa’s appeal and *inter alia*, held that the notice of dispute does not reveal a genuine dispute between the parties. Mobilox filed an appeal before the Supreme Court impugning the order of the NCLAT.

### ISSUE

What is the scope and ambit of the terms “dispute” and “existence of dispute” for determining the maintainability of an application filed by an Operational Creditor under the Code?

### JUDGMENT

The Supreme Court considered questions raised as to the triggering of the Code when it comes to debts owed to operational creditors and as to what would constitute a ‘dispute’ entitling the debtor company to have the Adjudicating Authority reject the application.

### Legislative intent

The Supreme Court first set out to understand the object and legislative intent behind the provisions of the Code pertaining to the issue of an ‘existence of a dispute’, and accordingly undertook a comparative study of the Insolvency and Bankruptcy Bill 2015 (“**2015 Bill**”) and the various committee reports leading up to it, with the final version of the Code to analyze the discrepancies in what was originally in the 2015 Bill and what came to be finally included in the Code.

#### 2015 Bill

Section 5(4) of the Bill annexed to the Bankruptcy Law Reforms Committee Report

“dispute” means a **bona fide** suit or arbitration proceedings relating to – (a) the existence or the amount of debt; (b) the quality of goods and service; or (c) the breach of a representation or warranty [Emphasis supplied]

#### The Code

Section 5 (6)

“dispute” **includes** a suit or arbitration proceedings relating to – (a) the existence or the amount of debt; (b) the quality of goods and service; or (c) the breach of a representation or warranty

#### Court’s Inference

In light of the fact that the word “bona fide” has been deleted from the Code, and the fact that the word “means” has been substituted with the word “Includes”, the definition of “Dispute” was intended to be an inclusive definition.

Since in its present avatar, Section 5(6) excludes the expression “bona fide” which is of significance, it is difficult to import the expression “bona fide” into Section

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Placing reliance on various judgments, the Supreme Court went on to observe that the word “*and*” occurring in Section 8(2) (a) must be read as “*or*” keeping in mind the legislative intent. This is permissible when done in order to further the object of the statute and/or to avoid an anomalous situation which would arise when:

- a. If read as “*and*”, disputes would stave off the bankruptcy process **only** if they are already pending in a suit or arbitration and not otherwise. Such a scenario would lead to great hardship; in that the dispute may arise a few days prior to the triggering of the CIRP and that parties may not have had time to approach an arbitral tribunal or a court yet.
- b. Given that limitation periods of up to 3 years are allowed until a person actually approaches a court or an arbitral tribunal to pursue legal remedies, such persons would fall outside the purview of Section 8(2) leading to CIRP commenced against them. Such an anomaly, the Supreme Court held, could not have been intended by the legislature.

### Threshold

The Supreme Court held that once an operational creditor has filed an Application, which is otherwise procedurally complete, the Adjudicating Authority has to consider the following;

- i. Whether there is an “operational debt”, as defined under the Code, which exceeds INR 100,000;
- 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;

While determining the third point above, the Supreme Court stated that all that the Adjudicating Authority must see is whether there is a plausible contention which requires further investigation and that the “dispute” is not a patently feeble argument or an assertion of fact unsupported by evidence. Interestingly, while the Court was of the view that it is important to separate the grain from the chaff and to reject a spurious defense which is mere bluster, it held that the Adjudicating Authority need not go into the merits and satisfy itself that the defense is likely to succeed at this stage of the proceeding.

Basis the above, the Supreme Court allowed the appeal and set aside the order of the NCLAT.

### ANALYSIS

There has been a spurt of jurisprudence on the meaning of the term ‘*dispute*’ so far this year wherein different Adjudicating Authorities have adopted different and sometimes conflicting interpretations, varying from the strictest to the most liberal and inclusive forms. This is the first time the Supreme Court has taken up the issue and provided much needed clarity to debtor companies who may have a genuine dispute regarding the debt but may not have yet initiated legal proceedings in lieu of the same.

The Supreme Court has clarified that the object of the Code coupled with the legislative intent 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 debtor companies into the CIRP prematurely or for extraneous considerations. Thus, the Court has attempted at striking a balance between the rights of an operational creditor vis-a-vis the remedy available to the debtor company.

The Supreme Court has also taken the opportunity to reiterate the importance of strict adherence to the timelines as set out in the Code being of essence to the insolvency resolution process.

The relevant provisions can be found [here](#).

— Siddharth Ratho & Sahil Kanuga

You can direct your queries or comments to the authors

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<sup>1</sup> Civil Appeal No. 9405 of 2017

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