

Insolvency and Bankruptcy Hotline

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NCLAT: WIDER DEFINITION OF "DISPUTE" TO RESIST AN ACTION FOR INSOLVENCY UNDER THE BANKRUPTCY CODE

- The National Company Law Appellate Tribunal ("NCLAT") interprets the definition of "*dispute*" under Section 8 and 9 of the Insolvency and Bankruptcy Code ("**Code**") to include, apart from existing suits and arbitrations, any other actions, proceedings, conciliation, mediation pending before any Court or Tribunals under any existing act or law in relation to an operational debt.
- Holds that an application initiating the insolvency resolution process would be rejected if the Corporate Debtor has raised the existence of a pending "*dispute*" with the applicant Operational Creditor.
- Onus to prove existing dispute pending before competent court of law or authority on Corporate Debtor
- National Company Law Tribunal ("**NCLT**") to form a prima facie view on the existence of dispute pertaining to debt and default and not go into adequacy of the same.

INTRODUCTION

The NCLAT in a recent judgment, Kirusa Software Pvt. Ltd. ("**Kirusa**") v. Mobilox Innovations Pvt. Ltd. ("**Mobilox**") has broadly interpreted the term "*dispute*" to be of wide ambit and scope, stating that the term cannot be confined to pending proceedings or '*lis*' within the limited ambit of a "*suit or arbitration proceeding*". Accordingly, an application for corporate insolvency resolution process ("**CIRP**") would be rejected if the Corporate Debtor has communicated the existence of a "*dispute*" which emanated prior to the initiation of the CIRP by an Operational Creditor. However, the NCLAT has also stated that a mere illusory dispute, raised for the first time by the Corporate Debtor while communicating the existence of a dispute, cannot be used as a tool to get an application for CIRP rejected by the Adjudicating Authority.

BRIEF FACTS

Kirusa issued a demand notice to Mobilox as an Operational Creditor, 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 alleging a breach committed by Kirusa of the terms of a Non-Disclosure Agreement between the parties.

Kirusa filed an application before the NCLT, Mumbai for initiation of CIRP against Mobilox which was dismissed by the NCLT, Mumbai because a notice of dispute had been issued by Mobilox. Kirusa filed an appeal before the NCLAT, claiming that the Mobilox Reply does not constitute a notice of dispute as contemplated under the provisions of the Code.

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 Section 9 read with section 5 and 8 of the I&B Code?

JUDGMENT

The Appellate Tribunal, while relying on Section 9 (5) (ii) (d) of the Code, had to determine whether an application filed by an Operational Creditor should be rejected if the Corporate Debtor in response to a demand notice for payment of debt, raises the existence of a "*dispute*" with the Operational Creditor. (*All relevant sections have been reproduced for reference as endnotes*)

Therefore, the key question in the appeal hinged on the interpretation of the scope and ambit of the term "*dispute*" in context of Section 9 read with section 8 and 5(6) of the Code. The Appellate Tribunal stated that as per Section 9 the NCLT can admit an application filed by an Operational Creditor *only* if no notice raising a valid "*dispute*" is received by the Operational Creditor. Therefore, as per the NCLT the existence of a "*dispute*" in respect of the operational debt claimed by the Operational Creditor would preclude the NCLT from admitting an application for initiation of CIRP.

The Appellate Tribunal observed that Section 5(6) of the Code which defines "*dispute*" mentions only a pending "*suit or arbitration proceedings*". The Appellate Tribunal relied on the Supreme Court judgment of *Mithlesh Singh v. Union of India*¹ to observe that, while interpreting statutes Courts have always presumed the legislature to have used every word for a purpose and therefore every part of a statute should be given effect. Therefore, the inclusion of any term within a statute reflects deliberate legislative intent. Considering this, the Appellate Tribunal relied on the Supreme Court judgment of *P. Kasilingam v. PSB College of Technology*² to interpret the scope of a definition when it uses the expression "*means*" or "*includes*" individually or collectively. It identified that the term "*means*" refers to the restricted definition as provided for in the statute and does not leave any scope for expansion of the definition. Whereas the term "*includes*" enlarges the meaning of the defined expression so as to include the natural meaning of the defined term, along with the definition provided for in the statute. Therefore, the Appellate Tribunal, proceeded to examine the

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term “*dispute*” in its natural and ordinary meaning, and upon reading the Code as a whole observed that the scope of “*dispute*” should cover all disputes and not be limited to only two ways of disputing a demand made by the Operational Creditor.

The Appellate Tribunal went on to inspect the term considering the intent of the legislature and held that, if the legislature had intended the definition of ‘*dispute*’ to be exhaustive and limited to only a suit or arbitration proceeding, the sub-section would have simply read as “*dispute means a dispute pending in arbitration or a suit*” without making the requirement inclusive.

Considering the aforementioned observations, the Appellate Tribunal harmoniously constructed the definition of “*dispute*” appearing in section 5(6) read with the Section 8(2) of the Code to mean that the term “*disputes*” would apply to all kinds of disputes, in relation to a debt and default.

The Appellate Tribunal went on to conclude that definition of “*dispute*” under Section 8 and 9 of the Code, when interpreted with the object and purpose of the Code, would mean any proceeding initiated or pending before any consumer courts, tribunal, labour court, mediation or conciliation, as well as any action taken by a Corporate Debtor under any act or law such as replying to a notice under section 80 of the Code of Civil Procedure, 1908, or an action under section 59 of the Sale of Goods Act, 1930 or an action regarding the quality of goods provided by an Operational Creditor. It essentially, includes any dispute raised in relation to clause (a) or (b) or (c) of section 5(6).

However, the Appellate Tribunal importantly stated that a dispute would have to 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 mala fide dispute just to stall the insolvency resolution process*”, for it to fall within the scope and ambit of section 8 and 9 of the Code. Therefore, the Corporate Debtor has the onus to prove that there exists a pending dispute raised before a competent court of law or authority prior to initiation of the CIRP.

Further, the Appellate Tribunal has also drawn a parallel between Section 8 and 9 of the Code with Section 8 of the recently amended Arbitration and Conciliation Act, 1996. It has stated that the NCLT, when presented with a notice of dispute, has to only *prima facie* decide whether there exists a dispute pertaining to the “*debt*” and “*default*” as referred to by the Operational Creditor. The Tribunal does not have the mandate to use its discretion to verify the adequacy of the dispute.

The Appellate Tribunal also highlighted the following differences between the initiation of a CIRP by a Financial and Operational Creditor

Requirement	Financial Creditor	Operational Creditor
Filling of Application	No condition precedent	Needs to issue a notice a demand of unpaid debt/invoice demanding payment prior to filing
Right to file Application	Can file on default	Accrues after expiry of ten days from the date of delivery of the demand notice
Notice of dispute	No provision	Corporate Debtor can respond to the demand notice within ten days by issuing a notice of dispute
Admission/rejection of Application	Application admitted if existence of debt and occurrence of default ascertained	Application admitted in case there is no notice of dispute Application rejected if there is a notice raising a valid dispute under the provisions of the Code

ANALYSIS

The I&B Code was enacted as a means to consolidate the already existing, but segregated laws in the country with regard to insolvency and bankruptcy. The Code is a positive step forward in creating a single platform for resolution of disputes and insolvency. However, the Code like any other nascent legislation is not free from ambiguity, one of the key interpretational issues that has arisen with respect to initiation of CIRP by an Operational Creditor is the scope of the definition of “*dispute*” as appearing in Section 8 and 9 of the Code.

Prior to the present judgment of the NCLAT, there were various conflicting decisions interpreting the meaning of the term “*dispute*”. In *Essar Projects India Ltd vs MCL Global Steel*,³ the Tribunal, while interpreting the definition of ‘*dispute*’ under the Code, held that ‘*dispute in existence*’ means and includes raising a dispute in a court of law or arbitral tribunal before the receipt of the Demand Notice issued under Section 8 of the Code. It also stated that a dispute raised by a Corporate Debtor for the first time in its reply to the demand notice cannot be treated as a dispute in existence in the absence of the same being disputed before any court of law prior to the receipt of the demand notice. The same view was taken by the NCLT in the case of *Deutsche Forfait vs Uttam Galva Steel*.⁴ It said that the NCLT had made it clear that such a dispute must be validated by raising the issues in dispute before a court or arbitral tribunal prior to the date of receipt of a demand notice. Merely contesting the amount in question did not constitute a ‘*dispute*’ within the meaning of the Code. However, the Delhi NCLT had taken the exact opposite view while stating that a dispute raised post issuance of a demand notice could also be considered as a valid dispute under the scope of section 9 of the Code.

As is evident, the previously ambiguous position on the scope of the definition of “*dispute*” has been finally resolved by the NCLAT, by stating the following:

- The term “*dispute*” must be interpreted in a wide an inclusive manner to mean any proceeding which had been initiated by the Corporate Debtor before any competent court of law or authority;
- The dispute should be in respect of (a) existence of the amount of debt (b) quality of goods and services or (c) breach of representation and warranty;
- The dispute should be raised prior to the issuance of a demand notice by the Operational Creditor;

- The Corporate Debtor would have to particularize and prove the dispute in respect of the existence of the “*debt*” and the “*default*”
- The dispute cannot be a *mala fide*, moonshine defense raised to defeat the insolvency proceedings.
- The NCLT would have to *prima facie* verify the existence of the pending dispute and not judge the adequacy of the same

The previous law on insolvency of corporate entities had a similar position, whereby if the creditors' debt was *bona fide* disputed on substantial grounds, the Court would ideally dismiss the winding up petition and leave the creditor to establish his claim in a separate action. A dispute would be considered substantial and genuine if it was bona fide and not spurious, speculative, illusory or misconceived.⁵

The initiation of CIRP by an Operational Creditor is a novel phenomenon in the Indian legal and corporate scenario and can prove to be a powerful tool in realizing operational debts even when the Corporate Debtor is not insolvent. Therefore, in light of the clarifications issued by the NCLAT and the requirements of the Code itself it has become vitally important and prudent for a Corporate Debtor to proactively take steps to raise a dispute in respect of unpaid invoices/dues of an Operational Creditor and put on record the existence of deficiency in service or goods or any breach of representation/warranty or any counter claim that the Debtor might have against the Operational Creditor so as to pre-empt any insolvency proceedings under Section 9 of the Code.

For Relevant section, please click [here](#).

— [Arjun Gupta & Vyapak Desai](#)

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¹ (2003) 3 SCC 309

² 1995 Supp. (2) SCC 348

³ CP No. 20/1 & BP/NCLT/MAH/2017

⁴ C.P. no. 45/I&BP/NCLT/MAH/2017

⁵ IBA Health(India) Private Ltd. Vs Info-Drive Systems Sdn.Bhd. (2010(10) SCC 553); Mediquip Systems Pvt. Ltd. vs Proxima Medical System G.M.B.H (AIR 2005 SC 4175)

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