

De Jure

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REDEFINING "DISPUTE" And "EXISTENCE OF DISPUTE" UNDER
THE INSOLVENCY AND BANKRUPTCY CODE, 2016



INTRODUCTION

The Insolvency and Bankruptcy Code, 2016 ("**IBC**") was enacted with the primary objective of consolidating and amending the laws relating to reorganisation and insolvency resolution of corporates, firms and individuals in a time bound manner to maximise the value of their assets. Under the IBC, an operational creditor can initiate a corporate insolvency resolution process ("**CIRP**") against the corporate debtor by filing an application before the National Company Law Tribunal ("**NCLT**").

UNDERSTANDING THE TERM "DISPUTE"

Section 5 sub-section (6) of the IBC defines dispute as follows:

"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.

Unlike a financial creditor who may directly file an application before the NCLT, the operational creditor has to comply with the requirements of Section 8 of the IBC, wherein the operational creditor has to deliver a demand notice or a copy of an invoice to the corporate debtor for the amount of the unpaid operational debt in respect of which the default has occurred. Sub-section (2) of Section 8 provides a 10 (ten) day window to the corporate debtor to either repay such unpaid amount as stated in the demand notice, or, bring to the notice of the operational creditor an 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 question that has arisen before various NCLT's was whether a corporate debtor can raise all kinds of dispute in the notice of dispute or can the notice of dispute only refer to pendency of a suit or an arbitration pending before receipt of the demand notice under section 8 of the IBC.

In *Essar Projects India Ltd. vs. MCL Global Steel Pvt. Ltd*, Mumbai NCLT, while interpreting the definition of dispute under IBC, held that dispute in existence means only when the same is raised before a court or an arbitral tribunal prior to the date of receipt of a demand notice and mere contesting of the amount in question in reply does not constitute a dispute within the meaning of IBC. The NCLT, Mumbai Bench also in the case of *DF Deutsche Forfait AG & Anr vs Uttam Galva Steel Ltd* amongst other things held that dispute under section 5 sub section (6) of the IBC and existence of dispute under section 8 of IBC would be an inclusive definition and the same should be pending before a court or an arbitral tribunal.

On the other hand, NCLT, New Delhi Bench in the case of *One Coat Plaster vs. Ambience Pvt. Ltd* took a very liberal interpretation and held that receipt of a notice of dispute is deemed sufficient to reject the application of the operational creditor. However, in the case of *Design Worx Infrastructure Pvt Ltd vs Premier Restaurant Pvt Ltd*, the NCLT New Delhi Bench held that dispute should not be given a rigid interpretation so as to mean only pendency of a suit or an arbitration and it will be sufficient when the corporate debtor in its reply can show existence of dispute with valid reasons and prior emails to record its dissatisfaction for the services rendered, it would amount to existence of dispute and CIRP in that event cannot be triggered.

The National Company Law Appellate Tribunal, ("**NCLAT**") in its recent order dated May 24, 2017, in the matter of *Kirusa Software Pvt Ltd vs Mobilox Innovations Pvt. Ltd.*, has now put to rest the controversy as to what would mean dispute and existence of dispute for the purpose of determination of an application under section 9 of the IBC.

FACTS OF THE CASE BEFORE THE NCLAT

Kirusa Software Private Limited ("**Kirusa**") issued a demand notice on Mobilox Innovations Private Limited ("**Mobilox**") as an operational creditor, demanding payment of certain dues. Mobilox issued a reply to the demand notice ("**Reply**") *inter-alia* stating that there exists serious and bona fide dispute between the parties as Kirusa had breached the terms of the non- disclosure agreement between the parties and divulged Mobilox's confidential information.

Kirusa filed an application before the NCLT, Mumbai for initiation of CIRP of Mobilox which was dismissed by the NCLT on the grounds that a notice of dispute has been issued by Mobilox. Kirusa filed an appeal before the NCLAT claiming that the Reply does not constitute a notice of dispute under IBC.

INTERPRETATION OF "DISPUTE" AND "EXISTENCE OF DISPUTE" IN KIRUSA

While interpreting the definition of dispute, NCLAT amongst others things have held the following:

1. The definition of dispute under section 5 sub- section (6) of the IBC is illustrative and not exhaustive;
 2. The word dispute (*if any*) have been added as a matter of convenience and/or to give meaningfulness and the true meaning to sub-section (2) of Section 8 of the IBC, having regard to the context of Sections 8 and 9 of the IBC emerges both from the object and purpose of the IBC and the context in which the expression is used, that disputes raised in the notice sent by the corporate debtor to the operational creditor would get covered within sub-section (2) of Section 8 of the IBC;
 3. Dispute will not just include suits or arbitrations but its ambit will extend to proceedings initiated or pending before consumer courts, tribunal, labour court or mediation and 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 or services provided by an operational creditor;
 4. Notice of dispute reply should be clear and not vague, so as to evade the liability. Further, the reply will be only relatable to the existence of the amount of the debt, quality of good or service or breach of a representation or warranty and the same should be raised prior to the issuance of demand notice under section 8 of the IBC and not afterwards;
 5. NCLT does not have the discretion to verify the adequacy of dispute and
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6. In view of Form 5 of Insolvency & Bankruptcy (Application to Adjudicating Authority) Rules 2016, CIRP under the IBC can also be triggered on a decree passed by a court or an award.

OUR VIEW

Though the NCLAT order was not in favour of Mobilox, the NCLAT order may come as a relief to all Corporate Debtors as the scope and meaning of the interpretation of the term Dispute is widened. Infact, the NCLAT has, in its subsequent judgements (also in the appeal from order in the case of Essar Projects India Ltd. vs. MCL Global Steel Pvt. Ltd), reiterated and upheld the same principles as laid down in Kirusa regarding the meaning of dispute and existence of a dispute.

The above interpretation allows the corporate debtor to be cautious when it is supplied with poor quality of goods or services by its dealers/vendors and the corporate debtor should as soon as possible inform to its vendor in writing about the defect/breach that it is disgruntled with the quality of goods or services supplied. The corporate debtor also in its reply should be able to demonstrate that payment has been withheld to such vendor for cogent reasons by giving necessary particulars and the same should not be an elusive reply.

The fact that, if the judgment of the NCLAT is to be read to permit the initiation of a CIRP on the basis of an arbitral award under Form 5 as mentioned above, going forward there may be some uncertainties vis-à-vis the fact that it would to an extent repudiate the statutory mechanism under the Arbitration and Conciliation Act, 1996 (as amended) ("**Act**"), in a way that a party would be forced to face legal consequences under the IBC in relation to such an award which the party otherwise would have challenged and also obtained a stay under the Act.

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