K KISHAN V. M/S VIJAY NIRMAN COMPANY PRIVATE LIMITED[1]

-PALAK LALL[2]

Abstract

The recent judgment of R.F. Nariman, J. and Indu Malhotra, J. in the case *of K.Kishan v. M/S Vijay Nirman Company Pvt. Ltd*., has expanded the meaning of the word "dispute" in the context of applications filed by the operational creditors for the initiation of Corporate Insolvency Resolution Process (CIRP) against the corporate debtors under the Insolvency and Bankruptcy Code (IBC), 2016. This judgment follows close on the heels of the landmark ruling of the Supreme Court in *Mobilox Innovation Private Ltd. v. Kirusa Software Pvt. Ltd.*[3] This recent decision of the Supreme Court has finally settled the question of whether the IBC, 2016 can be invoked in respect of an operational debt where an arbitral award has been passed against the corporate debtor but there is a pending proceeding challenging the arbitral award under Section 34 of the Arbitration and Conciliation Act, 1996. The judgment of the Supreme Court makes it clear that insolvency process under the Code cannot be used as a substitute for debt enforcement procedures contained in other statutes and thereby puts at rest the question of applicability of Section 238 of the IBC, 2016. The Supreme Court reversed the decision of the National Company Law Appellate Tribunal (NCLAT), thereby holding that challenge to an arbitral award under Section 34 of the Act is a "dispute" for the purpose of Section 8 of the IBC, 2016 and is thus, a bar to the initiation of insolvency proceedings under the Code. Through this submission, the author seeks to analyze in detail the extent to which a pending proceeding challenging an arbitral award impacts the initiation of CIRP under the IBC, 2016. This case comment is also an attempt to provide some clarity on the meaning of the word "dispute" as it has been interpreted over time.

Facts

M/S Vijay Nirman Company (Respondent) entered into a sub-contract with M/S Ksheerabad Constructions Pvt. Ltd. (KCPL) to undertake some work of construction and widening of the two

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lane highway to four lanes. Subsequently KCPL entered into another agreement with SDM Projects Ltd. and thus, there was a tripartite Memorandum of Understanding entered into between KCPL, SDM Projects Pvt. Ltd. and M/S Vijay Nirman Company. Certain disputes arose between the parties which were referred to an Arbitral Tribunal. The Arbitral Tribunal passed its award dated 21.01.2017 wherein it allowed a claim for a sum of Rs. 1,71,98,302 in favour of the respondent. Another claim for a sum of Rs. 13,56,98,624 was also allowed. However, KCPL'S counter-claims were rejected.

Thereafter, a demand notice dated 06.02.2017 under Section 8 of the IBC, 2016 was sent by the respondent to KCPL for the payment of a sum of Rs. 1,79,00,166. KCPL responded within 10 days of the receipt of demand notice thereby disputing it on the ground that the amount allowed is in fact a subject matter of arbitration proceedings. Subsequently, KCPL filed a petition under Section 34 of the Arbitration and Conciliation Act, 1996 challenging the award. Thereafter, a Section 9 application was filed by the respondent for the initiation of Corporate Insolvency Resolution Process under IBC, 2016. The respondent stated that the amount claimed by it formed a part of the award and thus, it had become an 'operational debt' thereby entitling it to initiate corporate insolvency resolution process.

NCLT by its order dated 29.08.2017 admitted the Section 9 application and held that the respondent is entitled to the said sum. NCLT further held that the fact that Section 34 petition was pending was irrelevant for the reason that the claim stood admitted and there was no stay of the award. Aggrieved by the order of NCLT, KCPL filed an appeal before the NCLAT which was dismissed on the ground that a non-obstante clause in Section 238 of the IBC, 2016 would override the Arbitration and Conciliation Act, 1996 and that the pendency of a petition under Section 34 would not amount to the "existence of a dispute".

Thereafter, an appeal was filed before the Supreme Court.

Contentions of the Parties:

Appellant

The appellant relying on the decision of the Supreme Court[4] contended that the object of the Code is not to replace debt adjudication and enforcement under other Acts including the Arbitration and Conciliation Act, 1996 and the moment there is a "real dispute" between the parties which may not be a "bona fide dispute" the IBC cannot be held to be applicable. It was thus contended that the very fact that there is a pendency of Section 34 petition is reflective of a "real and a pre-existing dispute". Another contention put forth was that if the cross-claim of the appellants so rejected by the Arbitral Tribunal is subsequently held to be wrongly dismissed, then the appellant would not be entitled to pay any sum to the respondent. It was contended that there is nothing inconsistent between the adjudication and enforcement process under the Act and application of Section 8 and 9 of the IBC, 2016 and as long as the existence of a dispute is established, the Act will apply.

Respondent:

The respondent majorly relied on the law in United Kingdom and Singapore thereby contending that mere pendency of an application to set aside the judgment, order or decision does not impede the insolvency proceedings. According to the respondent, the Appellate Tribunal was absolutely correct in applying Section 238 of the Code as it being a non-obstante clause will override the provisions of the Arbitration and Conciliation Act, 1996.

Findings of the Court:

The Court relied on Section 9(5)(ii)(d) of the IBC, 2016 which makes it very clear that once a notice of dispute has been received by the operational creditor, an application under Section 8 of IBC, 2016 cannot be entertained. The court also held that the fact that the reply to the notice given under Section 8 was within 10 days and raised the existence of a dispute cannot be doubted. The Court decided that challenging an arbitral award in itself shows that there is a pre-existing ongoing dispute which arose between the parties during the arbitral proceedings and may continue even after the award, till the final adjudicatory process is complete under Section 34 or Section 37 of the Arbitration and Conciliation Act, 1996. The Court did not agree with the respondent's contention that the debt set out in the demand notice has already been admitted by the appellant during the arbitral proceedings. The Court referred to the notes on clauses annexed

[4] *Supra,* note 2

to the Bill of Insolvency Code and thereby reiterated that operational creditors, whose debts are usually smaller, should not be able to put the corporate debtor into the insolvency resolution process prematurely or initiate the process for extraneous considerations.

The court held that mere factum of challenge of an arbitral award under Section 34 of the Arbitration and Conciliation Act, 1996 would be sufficient to state that the corporate debtor disputes the award and that such a case would be treated as a case of a pre-existing ongoing dispute. The court thus, made it clear that insolvency process, particularly in relation to operational creditors cannot be used to bypass the adjudicatory and enforcement process of a debt contained in other statutes.

The Court added that however, where the challenge to an arbitral award under Section 34 is barred by limitation, insolvency process can rightly be initiated. But this requires the operational creditor to demonstrate before the court that the period of 90 days plus the discretionary period of 30 days has expired, post which either no petition has been filed or a belated petition has been filed. The Court further added that insolvency process cannot be initiated where Section 34 petition has been filed in a wrong court without adjudicating on the applicability of Section 14 of the Limitation Act, 1963.

The Court held that there is no inconsistency between the IBC, 2016 and the Arbitration and Conciliation act, 1996, and thus the question of applicability of Section 238 of the Code does not arise. On the contrary, the court reiterated that the award passed under the Arbitration and Conciliation Act, 1996 along with the steps taken for its challenge makes it clear that operational debt happens to be a disputed one.

Analysis

The IBC, 2016 allows the operational creditor to initiate insolvency proceedings against the corporate debtor. There is a proper procedure laid down for the same in the Code. Under Section 8 of the Code, on the occurrence of a payment default, the operational creditor is required to deliver a “demand notice” to the corporate debtor demanding payment of the debt. The corporate debtor then has two options: he must either repay the debt within 10 days or he must bring to the notice of the operational creditor any “pre-existing dispute” i.e. one existing before the delivery of demand notice between him and the operational creditor (Notice of Dispute) within 10 days of

the receipt of demand notice. Corporate Insolvency Resolution Process can be initiated only if the operational creditor receives either no repayment of the debt or the "Notice of Dispute". Where a notice of dispute has been issued, the application for initiation of Corporate Insolvency Resolution Process would be rejected.

A question arises as to what would constitute a "dispute" for the purpose of initiation of insolvency proceedings. This question was put at rest by the landmark ruling of the Supreme Court[5] wherein it was held that the dispute between the corporate debtor and the operational creditor must be a pre-existing one i.e. it must exist before the delivery of demand notice by the operational creditor to the corporate debtor. What is meant by this is that the dispute must be a "real" and a "genuine" one. It should not be "illusory" or "hypothetical". It should not be a bogus or a sham which is brought up by the corporate debtor merely to avoid the initiation of insolvency proceedings or to save itself from being declared to be an insolvent.

The question before us in the present case is that "Whether a challenge to an arbitral award under Section 34 of the Arbitration and Conciliation Act, 1996 constitutes a "dispute" for the purpose of IBC, 2016. The answer to this question has been answered in the affirmative by the Honourable Supreme Court. However, every dispute is required to stand the test of genuineness and thus, even the challenge to an arbitral award has to be on genuine and reasonable grounds and must not be a mere eye-wash just to cause delays and hardships.

The Supreme Court[6] had held in its landmark ruling that it is for the NCLT to examine the following:

1. Whether there is an operational debt exceeding Rs. One Lakh?
2. Whether there is any documentary evidence which shows that the operational debt is due and payable?
3. Whether there is an existence of a dispute between the parties or the record of the pendency of a suit/arbitration filed before the receipt of the demand notice?

All these conditions are required to be fulfilled otherwise the application for initiation of insolvency proceedings is likely to be rejected. The Court held that in cases of operational debt,

[5] *Supra,* note 2,3
[6] *Supra,* note 2,3,4

what is important is that the existence of dispute or the suit or arbitration proceedings in respect thereof must exist before the receipt of the demand notice. In the present case, the challenge to an arbitral award under S.34 of the Arbitration and Conciliation Act, 1996 had been made by the corporate debtor prior to when he had received demand notice and was thus "genuine" and not "spurious". This "genuine pre-existing" dispute barred the initiation of Corporate Insolvency Resolution Process in the present case. The IBC, 2016 has brought about a big change in the power equation between operational creditors and corporate debtors. The whole process has become much more uniform as during the insolvency process the resolution professional exercises entire control rather than the promoters. This has helped in improving the ease of doing business. The present judgment as well as the Code makes sure that operational creditors having a claim of significantly lesser amount do not prematurely put the corporate debtors into the insolvency resolution process.

The Supreme Court by virtue of this judgment has put at rest the question of applicability of the non-obstante clause i.e. Section 238 of the Insolvency and Bankruptcy Code, 2016.

S.238 provides as follows:

"S.238: Provisions of this code to override other laws: The provisions of this Code shall have effect, notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law."

The appellant contended that there is nothing inconsistent between the adjudication and enforcement process under the Arbitration and Conciliation Act, 1996 and application of Section 8 and 9 of the IBC, 2016 and as long as the existence of a dispute is established, the Act will apply. On the other hand, the respondent contended that the Appellate Tribunal was absolutely correct in applying Section 238 of the Code as it being a non-obstante clause will override the provisions of the Arbitration and Conciliation Act, 1996. However, the Apex Court makes it clear that Section 238 applies only when there is an inconsistency between the IBC, 2016 and any other law. The non-obstante clause mentioned in Section 238 stipulates that the Code shall continue to operate even if its provisions are inconsistent with any other law in existence. However, in the present case there is no inconsistency between the Arbitration and Conciliation

Act, 1996 and the Insolvency and Bankruptcy Code, 2016 and thus, the question of applicability of IBC, 2016 does not arise.

Thus, this judgment is certainly a welcome development in the area of insolvency law and would provide the much needed hope to the corporate debtors who may have a genuine dispute regarding the debt under consideration.