In a recent order admitting a petition for insolvency resolution filed by Essar Projects India Limited (Operational Creditor) against MCL Global Steel Private Limited (Corporate Debtor), the National Company Law Tribunal (Mumbai Bench) (NCLT) has clarified what constitutes a ‘disputed debt’ within the meaning of Sections 8 and 9 of the Insolvency and Bankruptcy Code, 2016 (Code) and Rule 5 of the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016.

**Facts of the case**

The Operational Creditor was appointed to assist with the construction of a steel melt shop complex by the Corporate Debtor. However, despite raising invoices and sending reminder letters to the Corporate Debtor, the Operational Creditor’s dues remained unpaid. Seeking respite under the Code, the Operational Creditor issued a demand notice to the Corporate Debtor asking it to repay the amounts owed within 10 days or notify the Operational Creditor of an impending dispute in relation to the amount in default.

The Corporate Debtor responded to the demand notice denying its contents and adding that the Operational Creditor may not initiate insolvency proceedings as the debt was disputed by the Corporate Debtor. The Corporate Debtor highlighted that it disputed the amount in question, the quality and timeline of the construction (and ensuing losses arising out of such delay) and also stated that there are disputes about the enforceability of the contract between the parties. Therefore, it submitted that there was no admitted debt as such.

**Order of the NCLT**

The NCLT in an order dated 6 March 2017 held that the petition clearly revealed the existence of a debt and consequent default. It recognised that a demand notice was issued by the Operational Creditor in accordance with the procedure prescribed in the Code.

However, in relation to the Corporate Debtor’s reply and on an analysis of Section 5(6) (which relates to the definition of ‘dispute’) and Section 8 (which relates to insolvency resolution by an operational creditor) of the Code, it made the following observations:

- The reply by the Corporate Debtor highlighting disputes in relation to the amount in default was issued after the demand notice was served, whereas the
Code requires a pre-existing dispute (i.e. existing before the receipt of the demand notice) to be able to challenge a petition by an Operational Creditor.

- No civil suit or other proceedings were initiated against the Operational Creditor, therefore, a ‘dispute in existence’, i.e. the raising of a dispute in a court of law or an arbitral tribunal before the receipt of the demand notice - as is required under the Code - could not be established in the facts and scenario of this case.

Therefore, the NCLT ruled that the disputes/challenges raised by the Corporate Debtor were not sustainable and admitted the petition filed by the Operational Creditor.

**Khaitan Comment**

The ability of a corporate debtor to insulate itself from an application for insolvency resolution by an operational creditor hinges on the pre-existence of a ‘dispute’ in relation to the debt. The NCLT has 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. Mere contesting of the amount in question does not constitute a ‘dispute’ within the meaning of the Code.

Practically, any outcome boils down to a corporate debtor’s race to the courthouse versus an operational creditor’s race to the NCLT, with the first mover clearly having a greater advantage.

- Ashwin Bishnoi (Partner), Aayushi Anand (Senior Associate) and Tarang Shashishekar (Associate)

For any queries please contact: editors@khaitanco.com