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Insolvency and Bankruptcy Code: Insolvency Resolution Process by Operational Creditor / Trade Creditor

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The Insolvency and Bankruptcy Code, 2016 (“**Code**”) is considered as one of the biggest economic reforms. This Code gives flexibility to financial as well as operational creditors to initiate insolvency resolution process against those companies which have defaulted in making payment of Rs. 1,00,000 (Rupees One Lakh) or more towards the legitimate dues of the financial or operational creditors, the entire process is altogether different from the process of the old legislation namely ‘The Sick Industrial Companies (Special Provisions) Act, 1985 (SICA)’. Unlike SICA, the accumulated loss(es) is not a criterion to invoke the insolvency resolution process under the Code. This Code functions on the basis of default in making payment by the corporate debtor to the creditors under the Code. Since the inception of the Code, a total of 701 cases have been admitted out of which 310 cases are pertaining to operational debt. Over 2,000 applications have been closed, resulting in a recovery of about Rs 83,000 crore, according to news reports (As published in the *Insolvency and Bankruptcy Newsletter for the months of January to March 2018* by the Insolvency and Bankruptcy Board of India and the *Economic Times* on June 12, 2018 respectively).

The financial creditor has *inter alia* been defined to include such creditor who has lent some money to the defaulting debtor whereas the operational creditor has *inter alia* been defined to include such creditor who has to recover some amount from the debtor against the supply of goods or services. The process of invoking insolvency resolution process by an operational creditor is slightly different from the process to be followed by a financial creditor. In this article, we have only analysed the process to be followed by an operational creditor for invoking the insolvency resolution process.

Application to be filed with the Hon’ble National Company Law Tribunal

An operational creditor has been empowered to invoke the insolvency resolution process in terms of the provisions of the Code only if there is a ‘**default**’ in payment of goods supplied or services rendered by an operational creditor to the corporate debtor. Upon occurrence of default, an operational creditor is required to serve the demand notice (Form – 3) on the corporate debtor requiring it to make the payment within a period of 10 (ten) days or send the notice of default.

In case, the payment has not been made or no notice of ‘**dispute**’ has been received by the operational creditor within the aforesaid statutory period of 10 (ten) days, the operational creditor has the right to initiate insolvency process by filing its application (Form 5) with the relevant bench of the Hon’ble NCLT, which has jurisdiction over the place where the registered office of the corporate debtor is located.

The aforesaid application (Form-5) is required to be submitted with the Hon’ble NCLT along with the following documents:

1. A copy of the invoice demanding payment or the proof of delivery of demand notice (Form-3).
2. An affidavit to the effect that no notice of dispute regarding unpaid operational debt has been given by the corporate debtor.
3. A certificate from the bank in which the account of the operational creditor is maintained confirming that there is no receipt of the payment due to the corporate debtors along with bank account statements where credits are normally received by the operational creditor confirming non-receipt of the payment due to the corporate debtor. (In Re: **Macquarie Bank Limited Vs. Shilpi Cable Technologies Ltd.** [AIR 2018 SC 498], the Hon'ble Supreme Court of India held that the requirement of the bank certificate is directory in nature).

Existence of dispute

One of the highly debatable issues in relation to invoking insolvency resolution process by an operational creditor is rejection of the application by the Hon'ble National Company Law Tribunal (“NCLT”) on account of ‘**existence of dispute**’ between the operational creditor and the corporate debtor. The said issue has been analysed below.

Section 5 (6) of the Code defines the term “dispute”- *A "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;*

Now, it is imperative to understand what will construe as an ‘existence of dispute’. Will mere sending of notice of dispute by the corporate debtor be construed as an existence of dispute or should there be some genuine dispute?

In **Mobilox Innovations Private Limited V. Kirusa Software Private Limited**, Civil Appeal No. 9405 of 2017, the Hon'ble Supreme Court *inter alia* held that:

“40. It is clear, therefore, that once the operational creditor has filed an application, which is otherwise complete, the adjudicating authority must reject the application Under Section 9(5)(2)(d) if notice of dispute has been received by the operational creditor or there is a record of dispute in the information utility. It is clear that such notice must bring to the notice of the operational creditor the "existence" of a dispute or the fact that a suit or arbitration proceeding relating to a dispute is pending between the parties. Therefore, all that the adjudicating authority is to see at this stage is whether there is a plausible contention which requires further investigation and that the "dispute" is not a patently feeble legal argument or an assertion of fact unsupported by evidence. It is important to separate the grain from the chaff and to reject a spurious defence which is mere bluster. However, in doing so, the Court does not need to be satisfied that the defence is likely to succeed. The Court does not at this stage examine the merits of the dispute except to the extent indicated above. So long as a dispute truly exists in fact and is not spurious, hypothetical or illusory, the adjudicating authority has to reject the application.”

In view of the aforesaid judgment, it is clear that the term 'dispute' under the Code is illustrative and not exhaustive. It cannot be read solely restricted to dispute in relation to a suit or arbitration proceedings. The Hon'ble NCLT, before admitting the application, needs to examine and look into the matter to an extent required to ascertain whether actual dispute exists, or the dispute raised is a mere tool to avoid the insolvency resolution process.

Acceptance of application

Once the application (Form 5) for initiating insolvency resolution process is filed, the Hon'ble NCLT will accept the application if the following conditions are satisfied:

1. The application as filed should be **complete** in all respects.
2. There must **not be any repayment** of the operational debt.
3. The **notice for the payment of the debt** has been duly delivered by the operational creditor.
4. There is **no notice of dispute** which has been received by the operational creditor or there is **no record of dispute** with the information utility (*if applicable*).
5. There are **no disciplinary proceedings** pending against the proposed interim resolution professional (*To be complied with if the name of the interim resolution professional is mentioned in the application*).

The Hon'ble NCLT will dismiss or refuse the application if any of the aforesaid conditions are not satisfied or there is any pending dispute between the operational creditor and the corporate debtor as mentioned above.

Upon acceptance of the application

Upon acceptance of the application by the Hon'ble NCLT, the Hon'ble NCLT shall declare the moratorium period of 180 (One and Hundred Eighty) days, confirm the appointment of an Interim Resolution Professional ("**IRP**") and shall state the insolvency commencement date in its order. The moratorium period means a period wherein no judicial proceedings for recovery, enforcement of security interest, sale or transfer of assets, or termination of essential contracts can be instituted or continued against the corporate debtor. Subsequent to the above, the IRP will take charge of the management of the affairs of the corporate debtor and will make a public announcement in relation to the initiation of corporate insolvency resolution process inviting claims from the creditors, if any.

Upon receipt of the claims from the creditors, the IRP shall form a committee of creditors ("**COC**") and convene its meetings for taking actions on the insolvency resolution process which *inter alia* includes preparation of an information memorandum, appointment of a resolution professional and discussion on other relevant agenda items of the COC meeting. Thereafter, the resolution professional (as confirmed in the first COC meeting) shall take such steps as may be required for the revival of the corporate debtor in accordance with the provisions of the Code including preparation of the information memorandum, inviting expressions of interest for resolution plan, convening meetings of the COC as and when required, etc.

In the event, no resolution plan is agreed upon in the meeting of the COC and also approved by the Hon'ble NCLT within the aforesaid moratorium period of 180 (One Hundred and Eighty) days (which is extendable by another 90 (Ninety) days on the discretion of the Hon'ble NCLT), the Hon'ble NCLT may allow commencement of the liquidation process in relation to such corporate debtor.

A brief timeline of the insolvency resolution process is summarized in tabular form below for ease of reference:

Sr. No.	Particulars	Timeline	Directory / Mandatory
1.	Service of Form-3 i.e. demand notice by the operational creditor.	NA	Mandatory
2.	Filing of Form-5 i.e. application with the Hon'ble National Company Law Tribunal.	10 days after service of demand notice	Mandatory
3.	Raising of defect by the Registrar.	Time not specified under the Code	N.A.
4.	Defect to be cured by the operational creditor.	7 days from the date of notice by NCLT	Directory
5.	NCLT may either admit or reject the application.	14 days from the receipt of application	Directory
6.	Appointment of Insolvency Resolution Professional (applicable when the name of the IRP is not suggested in Form 5).	14 days from the admission of the application	Mandatory
7.	Completion of corporate insolvency resolution process.	180 days from the date of admission of the application (Extension of 90 days may be allowed by the NCLT)	Mandatory
8.	In case no resolution plan is agreed upon by the Committee of Creditors and subsequently approved by the Hon'ble NCLT, the liquidation process will commence.	After 180 days or 270 days (in case of extension) till the final order is passed by the Hon'ble NCLT	Mandatory

In Re: **Surendra Trading Company Vs. Juggilal Kamalapat Jute Mills Company Limited and Ors** [/(2018) BC 436 (SC)], the Hon'ble Supreme Court of India held that the period of seven days within which defect is to be cured by the operational creditor and the period of fourteen days within which the Hon'ble NCLT has to pass the order are both directory in nature.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.