

Insolvency and Bankruptcy Law in India

Dr. A. Sridhar

NALSAR University of Law, Hyderabad

Week 04

Lecture 16

Welcome to all.

In the last class, we discussed the CIRP process by the financial creditor. Today, we are going to discuss the initiation of CIRP by the operational creditor. Who is the operational creditor?

First of all, before discussing the operational creditor and the operational creditor's initiation of the CIRP process, we should know who the operational creditor is. So, section 5 subsection 20 defines the term operational creditor: an operational creditor means a person to whom an operational debt is owed and includes any person to whom such debt has been legally assigned or transferred. An operational creditor means any person to whom operational debt is owed.

Then what is the meaning of operational debt? Section 5, subsection 21, defines the term "operational debt." So, operational debt means a claim in respect of the provision of goods or services, including employment or debt in respect of payment of dues arising under any law for the time being in force and payable to the central government, any state government, or local authority. From this definition, we can understand that operational debt means it is a claim. The important terms are "claim," and it should be in relation to the provision of services or goods, so maybe including employment, and maybe it can include any amount that is payable to the central government or state government, as the case may be.

Now, in the case of New Okhla Industrial Development Authority versus Anand Sonbhadra, the Supreme Court held that three categories are included in the definition. The Supreme Court has explained in detail how it has interpreted the definition and categorized the claims into three categories. Any claim that arises out of the provision of goods is considered to be operational debt, as is any claim that arises out of any provision of services. So, whenever you are selling goods or providing services, you are supposed to pay some amount, which is referred to as operational debt. Any debt arising out of any law for the time being in enforcement is also included.

So, suppose we take the example that, because of the law, as a process of law, I may be liable to pay some amount; the court of law has given a judgment, there is an award, and there is a decree whereby I am liable to pay some amount to the opposite person. Even that is also considered operational debt. Like taxes, if you take the example of life taxes, claims arise out of the provision of goods. Now, let us try to understand that in the previous slide, we discussed that any claim that arises out of the provision of goods or any claim that arises out of the provision of services is considered to be operational debt. Now, let's try to discuss the meaning of claims arising out of the provision of goods.

What is the meaning of the goods? First of all, we should understand what the meaning of goods is. The definition of goods is given under the Sale of Goods Act, section 2, subsection 7, which defines goods as every kind of movable property. So, what is the meaning of goods? Goods means every kind of movable property, so whatever may be the movable property is called goods, other than actionable claims and money. Therefore, goods do not include actionable claims and money; you cannot include money because it is sovereign currency. It includes stock, shares, growing crops, grass, and things attached to or forming part of the land that are agreed to be severed before the sale or under the contract of sale.

So, if you observe the definition of goods, goods mean all kinds of movable property, so I can say it excludes immovable property. But what else is included in the definition of goods? Stock is included, so maybe opening stock and closing stock; when you have the inventory, the stock will be there. So, stock and shares, growing crops, and grass are things attached to or forming part of the land. Growing grass, growing crops, and things attached to or forming part of the land are actually all immovable. But once you agree to separate it, and once you agree to separate and sell it.

Let us take the example of iron ore. It is on the land, actually, so it is immovable, but you are extracting the iron ore and selling it. When you agree to sell the iron ore, and when you extract the iron ore, it is called a good. So that is the definition of a good. Then what is movable property? Because if you observe the definition of goods, goods include all kinds of movable property.

Then what is the meaning of movable property? Section 3, subsection 36 of the General Clauses Act defines movable property. Movable property shall mean property of any description, except immovable property. So, the General Clauses Act does not define movable property; rather, it excludes immovable property. That means that, other than the immovable property, every description of the property is included within the meaning of movable property. Now, let us try to understand what immovable property is.

Immovable property shall include land, benefits to arise out of the land, and things attached to the land that are permanently fastened to the earth. Whenever something is

immovable, it is something that cannot move, anything that is attached to the land, any benefit that arises out of the land. Suppose you take the example of a building, which is immovable property. Things attached to the earth are permanently fastened. For example, if you install one plant permanently, and if you want to move it, you have to dismantle it, then that is permanently fastened.

Then, that is called immovable property. Goods include anything that is not permanently attached to immovable property. So, if it is not permanently attached to the immovable property, such things are considered to be goods. Now, for example, software, electricity, and water can be moved from one place to another, though you cannot see the electricity; it can be transferred from one place to another. So, they are considered to be goods within the meaning of the sale of goods.

Therefore, we can take the same definition here. And if you observe the previous slide, let us go to the next slide. What is considered to be operational debt? Any claim that arises out of the provision of the goods we have discussed, what is the meaning of goods? Now, any claim that arises out of any provision of services. Now, let us try to understand what service provision is, so there is no definition under the Insolvency and Bankruptcy Code. So, the definition we can take from the Consumer Protection Act, Section 2, Subsection 42 of the Consumer Protection Act defines the term service.

Service means, it's a very broad definition: service means service of any description which is made available to potential users and includes, but is not limited to, the provision of facilities in connection with banking, financing, insurance, transport, processing, supply of electricity or other energy, telecom, boarding or lodging or both, housing construction, entertainment, amusement, and the prevailing of purveying of news and other information. So, they have included "service" to mean any description made available to potential users. It can be banking, financing, or insurance. So, like that, we have a list. All these things are considered to be services.

Then any transaction that pertains to the performance of any function for the sake of another would fall within the realm of service. So, what can be included in the definition of service? So, in the definition of service, any transaction that pertains to the performance of any function, so I am performing something. So, for the purpose of another person, I am performing something. Then, when I am performing something for the purpose of another person, that is called service. What is essential here? The service must be rendered to the corporate debtor, not to a third party.

If it is rendered to a third party, then that is not an operational debt. Okay, so if you want to consider any service as an operational debt—I mean, rendering services as an operational debt—the service must be rendered to the corporate debtor and not to any other third party. This was held in the case of Embee Software Pvt Ltd versus Solicon Pvt

Ltd. Whether employee dues or workman dues are operational debt, is it considered to be an operational debt? NCLAT, in the case of Kishore K Lonkar versus Hindustan Antibiotics Limited, held that all dues, all forms of dues, including dues in the nature of provident fund, gratuity, bonus, welfare claims, etc., will form part of the dues owed to the creditor.

So, as per the law, even employee dues and workman dues are considered to be operational debt. So, who is a workman? They are using the words employee and workman. Then what is the meaning of "workman"? A workman is defined under the Industrial Disputes Act. So, you have to take the definition from the Industrial Disputes Act. Then amounts payable under any law for the time being in force.

So, what is the meaning of amounts payable under any law? Maybe in the nature of income tax. So, under the income tax, you are supposed to pay the income tax. Maybe sales tax or professional tax; there are so many taxes. NCLAT, in the case of Director General of Income Tax Administration and TPS versus Synergies Dooray Automotive Limited, held that statutory dues have a direct nexus to the company's operation. Why is it considered so? Because it is a statutory due.

So, why should we consider it an operational debt? The Supreme Court has given—sorry, NCLAT—they have made an interesting observation. Because the statutory dues have a direct nexus with the operations of the company, if you want to run the business, you are supposed to pay the statutory dues. Without paying the statutory dues, you cannot run the business. That is why there is the opinion that statutory dues are essential for operating the business, and that is why they are considered operational debt. In this case, it was held that statutory dues have a direct nexus with the company's operation.

That is why statutory dues will come within the purview of operational debt. Then, whether any advance paid for the provision of goods or services will be included. Suppose I am paying you some amount. In the near future, you are going to render the services, or else in the near future, you are going to provide the goods. So, in such cases, any advance that is paid for the provision of the goods or services will be considered to be operational debt.

In the case of Consolidated Construction Consortium Limited versus Hitro Energy Solutions Private Limited, the Supreme Court held that claims for a refund of money would fall within the definition of operational debt. So, whenever I claim a refund of money, will it fall within the definition of operational debt? Who are operational creditors? Operational creditors are those whose debts arise from operational transactions. Therefore, if any person is entitled to receive money from operational transactions, they are considered to be operational creditors. So, he is giving one example of transactions involving goods or services considered necessary for the entity's

operational function. Section 5, subsection 25 defines operational debt as a claim in respect of the provision of goods or services.

So, the operative requirement is that a claim must be for some excess in the provision of goods or services. So, whenever you are giving some advance for the provision of goods or services, So, from the definition, you can understand that operational debt occurs whenever there is a nexus with the provision of services or goods. So, when you pay an advance for the provision of goods or services, that is considered to be operational debt. So, the appellant had sought an operational service from Hetero. When it contracted with them for the supply of light fittings, there was an issue.

In this case, the law states that the appellant is Consolidated Construction Consortium Limited. They entered into an agreement with Hetero for the supply of some light fittings. The encashment of a cheque by Hetero, even though the contract was terminated, gave rise to an operational debt in favor of the appellant. When they tried to encash the cheque given by Hetero and there was a failure, it amounted to an operational debt. Then, another question: what amounts to operational debt? Lease rent owed to the landlord: Is it an operational debt? That is the question.

So, it is a five-judge bench of the NCLAT. So, this is the case of Jaipur Trade Expo Central Private Limited versus Metrojet Airways Training Private Limited. So, in this case, NCLAT held that money owed to landlords under lease or other arrangements would constitute operational debt because you are using the land for the purpose of your business. So, any money that is owed to landlords under a lease or other arrangements would constitute operational debt within the meaning of this act. Tenants' claims against the corporate debtor arise when a tenant claims an amount against the corporate debtor.

NCLAT, in the case of D&I Tax Conservices Private Limited versus Vinod Kumar Kothari, held that a tenant in a lease on the premises of CD has a right to occupation only. Interestingly, in the case of a tenant, he has only the right to occupy. He doesn't have any right to receive, so he cannot be an operational creditor. In the case of a lease, the money owed to the landlord under the lease agreement makes him an operational debtor. In the case of a claim arising from the tenancy, he only has the right to occupy the premises, so he is not considered to be an operational creditor.

Then, whether liquidated or unliquidated damages are included. So, what are liquidated or unliquidated damages? Whenever you are entering into any contract, whereby, in case of breach, the amount the opposite party is supposed to pay, as specified in the contract itself, is called liquidated damages; unliquidated damages depend on the assessment of damages, and subsequently, the court of law is going to fix the damages. Liquidated damages are those that are already fixed, whereas unliquidated damages are those that are not fixed. So, whether it is considered to be operational debt in the case of Sanjeev

Kumar versus Aithen Technologies Pvt Ltd, NCLAT held that a claim for damages cannot be an operational debt because that is why no application under Section 8 can be made. Because you are claiming that it is not yet fixed, whenever you are claiming it means that you are asking the opposite person to pay.

So, unless that is fixed by the court of law, it is not crystallized. Therefore, any claim for damages cannot be an operational debt. But where the claim for damages is crystallized, that means you went to the court of law, the court of law has already accepted the claim, and they gave the order or they gave the decree stating that so and so person you are entitled to receive so and so money. So, in such cases, the claim for damages is crystallized. Then, if it is crystallized, then it is an operational debt.

So, in simple language, if the claim for damages is not crystallized, it is not considered operational debt. The claim for damages is crystallized; that is, if a court order is present or any award is made, then in such cases it is considered to be operational debt. Then who has to prove whether the debt is real or not? So, whether there is a due or not, the burden to prove the claim is on the creditor. So NCLAT, in the case of I Value Advisors Private Limited versus Srinagar Banihal Expressway Limited, held that whenever any creditor is claiming a certain amount to be received from the corporate debtor, the burden of proving the claim is on the creditor. But please remember, there is no specific manner or mode in which such facts need to be proved.

So, depending on the circumstances, you may have some receipts, you may have some award, you may have some decree, whatever it is. So, depending on the circumstances, you have to prove, but the burden lies on the operational creditor. So, the assignment of debts due does not change the nature of the debt. So here, please remember that merely by assigning, suppose if I am assigning my right to receive the debt to another person, will it change the impact? Will it change the law? No, it will not change the position. So, even if you are assigning the debts to another person, in such a case, the other person to whom the assignment is made is considered to be the operational creator.

So, he has the right to file the claims. In the case of Co-op Robobank QVS Singapore Branch versus Shailendra Ajmera, it was held that the assignment of debts does not change the nature of the debt. Let us recap what we have discussed so far. In this chapter, in this session, we have discussed who an operational creditor is. Then, subsequently, we have discussed claims. We have discussed that an operational creditor means any claims arising out of the provision of goods or services.

So, what is operational debt? Operational debt means any claims that arise out of the provision of goods and services. Then, subsequently, we discussed the definition and meaning of goods and services. Then, in the next class, we will discuss the procedure for applying by the operation creator. So, in this lesson, we discussed the legal provisions

under the IBC. Then, in the subsequent sessions, we are going to discuss the procedural aspects.

So, the legal part we have discussed in this session. The procedural part we are going to discuss in the next session.

Thank you.