M. Ravindranath Reddy vs G. Kishan & Ors on 17 January, 2020

NATIONAL COMPANY LAW APPELLATE TRIBUNAL, NEW DELHI

Company Appeal (AT) (Insolvency) No. 331 of 2019

[Arising out of Order dated 21st January 2019 passed by NCLT, Hyderabad in CP (IB) No. 134/09/HDB/2018]

IN THE MATTER OF:

Mr. M. Ravindranath Reddy ...Appellant
Versus
Mr G. Kishan & Ors. ...Respondents
Present:
For Appellant: Shri Buddy A. Ranganathan and
Ms Aditi Sharma, Advocates

For Respondent: Shri Saurabh Jain and Shri Smarth Arora,
Advocates

JUDGMENT

[Per; V. P. Singh, Member (T)] This appeal has been filed against the order dated 21st January 2019 passed by the National Company Law Tribunal, Hyderabad Bench, whereby the petition filed under Section 9 of the Insolvency and Bankruptcy Code, 2016, has been admitted against the Corporate Debtor Respondent No. 5, M/S. Walnut Packaging Private Limited.

The Appellant is the Director of the Corporate Debtor Company, and the Respondent herein was the applicant before the National Company Law Tribunal, claiming to be the Operational Creditors.

Brief facts, as stated by the Respondent/Applicant, is that the Respondents are the Lessors and the Corporate Debtor - M/s. Walnut Packaging Private Limited is the Licensee of Industrial Premises consisting of land measuring about 1667 sq. Yards, situated at Kukatpally, Hyderabad.

That tenancy of the Appellant was yearly, and the rent payable for the period from July 2011 to June 2017 was Rs. 85,67,290/- and the Corporate Debtor / Appellant is stated to be making part payments of lease rent from July 2011 until December 2016, totalling to Rs. 49,96,728/-, after deduction of Rs. 5,55,192/- as TDS. The aggregate credit to the Corporate Debtor's account was Rs. 55,51,920/-. The Corporate Debtor stopped making the payment from January 2017, after the last part payment was made, which was adjusted towards rental dues. The dues against the Corporate Debtor at the end of June 2017 was Rs. 30,15,370/-. After that, the Respondent /Petitioner issued a legal notice dated 15-06-2017 to handover the property back to the Petitioners, but the Corporate Debtor failed to vacate the property. After that, an eviction suit was filed against the Corporate Debtor before the jurisdictional Civil Court.

The learned counsel for the Respondent / Petitioner further submitted that the Demand Notice U/S 8 of I&B Code 2016 dated 18-01-2018 was also issued against the Corporate Debtor demanding Rs. 49,51,605/-, which was duly served on the Corporate Debtor.

The Corporate Debtor/Appellant submitted that he had paid the rent until December 2017, and no amount is due to the Petitioner. It is further stated that due to slowdown in the Operations of the Corporate Debtor during the period from April 2012 to July 2012 Petitioner/Respondent agreed on a moratorium for no yearly enhancement of rent for six years.

The Adjudicating Authority held that the Corporate Debtor had taken the property of the Petitioners on rent and they were paying rent up to June 2017. But the Corporate Debtor failed to pay the rent from July 2017onwards.

The Adjudicating Authority has stated that:

> "The main issue in the matter is as to whether the Petitioners accepted a moratorium for no enhancement of rent for six years or not? Though the Corporate Debtor says so, but there is no documentary proof filed to that effect. In the absence of any documentary proof about accepting the moratorium, the submissions of the Corporate Debtor are to fail. It is deemed that the Corporate Debtor has failed in making payment of rents as no substantial document is placed on record to show the existence of moratorium between the parties regarding the Rent. Therefore, I am inclined to admit the Petition".

The following question arises for our consideration :

> 1. Whether a landlord by providing lease, will be treated as providing services to the corporate debtor, and hence, an operational creditor within the meaning of Section 5(20)read with Section 5(21) of the 'Insolvency and Bankruptcy Code, 2016?
>
> 2. Whether the petition filed U/S 9 of the Insolvency and Bankruptcy Code 2016 is not maintainable on account of 'pre-existing dispute'?

Heard the learned counsel for the parties and perused the record. Admittedly, the petitioner has filed this petition under Section 9 of the I&B Code, 2016 in respect of purported non-payment of enhanced rent totalling of Rs. 49,51,605/- (subsequently reduced to Rs. 35,94,090/- by the Respondent). The Lease deeds was valid from 12-05-1998 up till 2006, was executed and registered between the parties. The Appellant corporate debtor contends that the original tenancy was yearly, with the enhancement of rent @10 % per year, over and above the last paid rent.

The Corporate Debtor has been regular in paying the rent in terms of lease deed with a 10% increase per annum. The original lease expired in 2006, and after that, for the period, i.e. 2011 to 2017 (disputed period) there was no agreement for enhancement of rent. The rent claimed by the Respondents from the Corporate Debtor Company from July 2011 to June 2017 was Rs. 85,66,290/-

and the Respondent paid a sum of Rs. 55,51,920/- and therefore the Corporate Debtor was in arrears of rent amounting to Rs. 30,15,270/-.

The Respondent/Operational Creditor further contends that a notice under Section 106 of the Transfer of Property Act 1882 was issued against the corporate debtor on 15-06-2017, to terminate the lease, and was asked to vacate the premises. The respondent also stated that he had claimed arrears of lease rent as well as mesne profits.

After that Operational Creditor issued Demand Notice under Section 8 of the I&B Code, 2016 raising a demand of Rs, 49,51,605/- i.e. 39,98,926/- towards rent(from July 2011 to December 2017) and interest at 18% per annum is Rs. 9,52,679/- in January 2018, and after that filed the petition under Section 9 of the I&B Code, 2016, was filed, which has been admitted by the impugned order.

The Insolvency and Bankruptcy Code ("Code") recognises two types of debt to enable the creditors to make an application for initiating insolvency proceedings against the corporate debtor- financial debt and operational debt. If there is a debt, other than a financial debt or an operational debt, the creditor will not qualify to apply under Sections 7 or 9, as the case may be. Hence, the determination of nature of claim/debt is an important step while considering the admission of an application under the Code.

While the law is still evolving, there are certain categories of dues, about which, the debate as to their classification into financial or operational debt continues. One such debt claims on account of unpaid rent payable by an entity to a landlord are in question in the present case. The Appellant also placed reliance on the provisions of the Central Goods and Services Tax Act, 2017. Schedule- II of the Act list down the activities that are to be treated as supply of goods or services, and paragraph 2 of the schedule stipulates as follows:

> "(a) any lease, tenancy, easement, licence to occupy land is a supply of services;
>
> (b) any lease or letting out of the building including a commercial, industrial or residential complex for business or commerce, either wholly or partly, is a supply of services."

This Tribunal, in the case of Jindal Steel & Power Ltd. v. DCM International Ltd. Company Appeal (AT)(Insolvency) No 288/2017 , held as follows:

> "Admittedly, the Appellant is a tenant of Respondent- . Even if it is accepted that a Memorandum of Understanding has been entered between the parties in regard to the premises in question, the Appellant being a tenant, having not made any claim in respect of the provisions of the goods or services and the debt in respect of the repayment of dues does not arise under any law for the time being in force payable to the Central Government or State Government, we hold that the Appellant tenant do not come within the meaning of 'Operational Creditor' as defined under sub-section

> (20) read with sub-Section (21) of Section 5 of the Insolvency and Bankruptcy Code, 2016 (hereinafter referred to 'I&B Code') for triggering Insolvency and Bankruptcy Process under Section 9 of the 'I&B Code'"

Relying on the judgment above of NCLAT, C.P. No.567/IB/2018 Citicare Super Speciality Hospital v. Vighnaharta Health Visionaries Pvt. Ltd. Dated 11th March 2019, NCLT, Mumbai Bench dismissed the petition, which was about arrears of license fee.

NCLT, New Delhi, in Parmod Yadav &Anr v. Divine Infracon (P) Ltd., 2017 SCC OnLine NCLT 11263 observed that the word "operational" or for that matter "operation" has not been defined anywhere in the Code. The General Clauses Act, 1897, also do not define the term. Hence, the term has to be given a meaning as ordinarily understood. The dictionary meaning of „operational is given as „of or relating to operation (Merriam Webster). Similarly, the meaning of „operation is given as „ready for use or able to be used .

Further, from the usage of the term "goods or services" as given under Section 14(2) of the Code, provides that "essential goods or services", of the corporate debtor shall not be terminated or suspended or interrupted during the moratorium. What constitute essential goods and services are provided under Regulation 32 (Insolvency Resolution Process for corporate persons) Regulation 2016 wherein it is provided that;

The essential goods and services referred to in Sec 14(2) shall mean:

> 1 Electricity 2 Water 3 Telecommunication Services 4 Information Technology Services To the extent, these are not a direct input to the output produced or supplied by the corporate debtor.

Thus, any debt arising without nexus to the direct input to the output produced or supplied by the corporate debtor, cannot, in the context of Code, be considered as an operational debt, even though it is a claim amounting to debt.

However, without going into the aspect whether an immovable property in itself constitutes stock-in- trade of the corporate debtor and has a direct nexus to its input- output, being an integral part of its operations, the Bench held that lease of immovable property cannot be considered as a supply of goods or rendering of services, and thus, cannot fall within the definition of operational debt. In this regard, reliance was also placed on Col. Vinod Awasthy v. AMR Infrastructure Ltd.

Further, relying on Jindal Steel (supra) and Citicare (supra), NCLT Hyderabad also, in the case of CP/IB/61/9/HDB/2019 Manjeera Retail Holdings Pvt. Ltd. v. Blue Tree Hospitality Pvt. Ltd., held that the petitioner claiming default in payment of rent of the premises leased out cannot be treated as an operational creditor, and the amount involved cannot be treated as an operational debt.

Section 5(20) of the Code, defines an "operational creditor" to mean "a person to whom an operational debt is owed and includes any person to whom such debt has been legally assigned or

transferred." In turn, Section 5(21) defines an "operational debt" to mean "a claim in respect of the provision of goods or services including employment or a debt in respect of the payment of dues arising under any law for the time being in force and payable to the Central Government, any State Government or any local authority."

Therefore, an operational debt is essentially a claim in respect of the following:

(a) provision of goods;

(b) provision of services, including employment; or

(c) a debt arising under any statute and payable to Government/local authority.

If the claim by way of debt does not fall under any of the three categories as mentioned above, the claim cannot be categorised as an operational debt, even though there may be a liability or obligation due from the corporate debtor to the creditor, and hence, such a creditor disentitled from maintaining an application for initiation of corporate insolvency resolution process (CIRP) of the corporate debtor.

There seems to be some rationale in restricting only to operational creditors for initiation of CIRP, other than financial creditors. Default committed to operational creditors about payment of their debt connotes that the corporate debtor is not even in a position to service the regular payments and operational expenses, as required in the day-to-day functioning of the corporate debtor, which provides a clear indication to its insolvency, warranting the resolution process being put in place.

The law has not gone into defining goods or services - hence, one has to rely on general usage of the terms so used in the law, with due regard to the context in which the same has been used. Simultaneously, it is also relevant to understand the intention of the lawmakers. The Bankruptcy Law Reforms Committee (BLRC), in its report dated November 20151, states that "Operational creditors are those whose liability from the entity comes from a transaction on operations". While discussing the different types of creditors, the Committee points out that "enterprises have financial creditors by way of loan and debt contracts as well as operational creditors such as employees, rental obligations, utilities payments and trade credit." Further, while differentiating between a financial creditor and an operational creditor, the Committee indicates "the lessor, that the entity rents out space from is an operational creditor to whom the entity owes monthly rent on a three-year lease". Hence, the BLRC recommends the treatment of lessors/landlords as operational creditors. However, the Legislature has not completely adopted the BLRC Report, and only the claim in respect of goods and services are kept in the definition of operational creditor and operational debt u/s Sec 5(20) and 5(21) of the Code. The definition does not give scope to the to interpret rent dues as operational debt.

The Code provides that for an amount to be classified as an Operational Debt under I&B Code, 2016 the alleged claim should fall in the definition of: -

3(6) "Claim" means -

(a) a right to payment, whether or not such right is reduced to judgment, fixed, disputed, undisputed, legal, equitable, secured or unsecured;

(b) right to remedy for breach of contract under any law for the time being in force, if such breach gives rise to a right to payment, whether or not such right is reduced to judgment, fixed, disputed, undisputed, legal, equitable, secured or unsecured;

3(11)"debt" means a liability or obligation in respect of a claim which is due from any person and includes a financial debt and operational debt;

3(12)"default" means non-payment of debt when whole or any part or instalment of the amount of debt has become due and payable and is not [paid] by the debtor or the corporate debtor, as the case may be;

5(20)"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; 5(21)"operational debt" means a claim in respect of the provision of goods or services including employment or a debt in respect of the [payment] of dues arising under any law for the time being in force and payable to the Central Government, any State Government or any local authority; The Legislature did not include here the reference to rent dues of property. Thus, it is clear that a claim in respect of the provision of goods or services is covered under the operational debt. This petition has been filed for recovery of enhanced rent as per lease agreement; this is not about the goods or services or in respect to goods or services.

This Appellate Tribunal has also held on 28-11-2017 in Company Appeal (AT) (Insolvency) No. 288 of 2017 is given below: -

„Admittedly, the Appellant is a tenant of Respondent- „Corporate Debtor . Even if it is accepted that a Memorandum of Understanding has been entered between the parties regarding the premises in question, the Appellant being a tenant, having not made any claim in respect of the provisions of the goods or services and the debt in respect of the repayment of dues does not arise under any law for the time being in force payable to the Central Government or State Government, we hold that the Appellant tenant do not come within the meaning of „Operational Creditor as defined under sub-section (20) read with sub-Section (21) of Section 5 of the Insolvency and Bankruptcy Code, 2016 (hereinafter referred to „I&B Code) for triggering Insolvency and Bankruptcy Process under Section 9 of the „I&B Code .

We are also do not find the term is defined under the General Clauses Act, 1897 and hence the term has to be given the meaning as ordinarily understood. The dictionary meaning of 'Operational' is given as 'of or relating to the operation or an operation'.

> For an amount to be classified for an operational debt under I&B Code, 2016, it is provided:
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> Firstly, the amount falls within the definition of "claim" as defined under Section 3(6) of the Code;
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> Secondly, such a claim should claim within the confines of the definition of a 'debt' as defined under Section 3(11), meaning it should be by way of a liability or obligation due from any person;
>
> Thirdly, such a "debt" should fall strictly within the scope of an "Operational Debt" as defined under Section 5(21) of the Code, i.e. the claim should arise in respect of
>
> (i) provision of goods or services including employment or
>
> (ii) A debt in respect of the repayment of dues arising under any law for the time being in force and payable either to the Central Government, any State Government or any local authority.

The word "in relation to Government" or local authority and the dues owed to it, has been given a wide platform. It is important to see whether persons other than the Government or local authority can claim the benefit, that any debt owed should be construed as an 'operational debt' other than those classified as 'financial debt'.

Thus, only if the claim by way of debt falls within one of the three categories as listed above, can be categorised as an operational debt. In case if the amount claimed does not fall under any of the categories mentioned as above, the claim cannot be categorised as an operational debt, and even though there might be a liability or obligation due from one person, namely Corporate Debtor to another, namely Creditor other than the Government or local authority, such a creditor cannot categorise itself as an "Operational Creditor" as defined under Section 5(21) of the I&B Code, 2016. Therefore, we are of the considered opinion that lease of immovable property cannot be considered as a supply of goods or rendering of any services and thus, cannot fall within the definition or 'Operational Debt.

In case of lease of immovable property, Default can be determined, on the basis of evidence. While exercising summary jurisdiction, the Adjudicating Authority exercising its power under Insolvency and Bankruptcy Code 2016, cannot give finding regarding default in payment of lease rent, because it requires further investigation. In the present case itself the Corporate Debtor' in its reply to the Demand Notice dated 9th February 2018, stated in paragraph 6 that: -

> "With regard to the allegations in paragraph no. 5 of the notice under reply, it is true that your clients got a legal notice dated 15.06.2017 issued under Section 106 of the Transfer of Property Act, 1882 calling upon my client to vacate the premises within six months ending with 31st December 2017. It is also true that your clients had

demanded rental amount at Rs. 1,63,926/- (Rupees one lakh sixty three thousand nine hundred and twenty-six only) per month besides demanding alleged arrears of rents amounting to Rs. 30,15,370/- (Rupees thirty lakhs fifteen thousand three hundred and seventy only) failing which your clients demanded payment of interest at 18% per annum. It is also true that in the said notice your clients had demanded mesne-profits at Rs. 3,00,000/- (Rupees three lakhs only) per month. My client states that immediately on receipt of the said notice, the Director of my client's company, Shri M Nihal Reddy contacted you and expressed surprise as to why such a demand for enhanced rent is being made when there was an understanding with your clients that your clients would not enhance the rent for a period of six years and when your clients have accepted the rental payments being made every month without demur or protest. My client further states that when its Director assured about payment of enhanced rents by 10% beginning from July 2018, your clients agreed for the same and continued to receive rents as originally agreed, i.e. Rs. 84,116/- (Rupees eighty-four thousand one hundred and sixteen only) per month. Under the circumstances, my client states that the present notice issued under the Insolvency and Bankruptcy Code, 2016 and the Rules framed thereunder is quite misconceived besides being against the letter and spirit of the understanding reached between your clients and my client.

On perusal of the above reply of the 'Corporate Debtor,' it is clear that before issuance of Demand Notice dated 8th January 2018 the Appellant had issued legal notice dated 15th June 2017 under Section 106 of the Transfer of Property Act, 1882, calling upon to vacate the premises within six months ending with 31st December 2017. It is also stated in the reply that the Director of the Company Shri M Nihal Reddy has questioned on demand for enhancing rent, based on an understanding, that rent would not be enhanced for six years.

On perusal of the above reply, it is evident that the 'Operational creditor' himself has admitted that before issuance of demand notice U/S 8 of the Code, notice to vacate the leasehold premises under Section 106 of the Transfer of Property Act, and termination of the lease was issued. The lessee / corporate debtor has also stated that there was an understanding regarding moratorium for not increasing rent for six years. But such type of questions whether rent enhancement was as per mutual understanding or not, can only be decided on the basis of evidence and by the competent court having jurisdiction. But the Adjudicating Authority admitted the petition U/S 9 of the Code, without considering the fact, that there was a pre-existing dispute regarding enhancement of rent, much before the issuance of demand notice.

Thus, it is clear that the landlord, who filed an application for recovery of alleged enhanced lease rent, can not be treated as an operational creditor within the meaning of Section 5(20)read with Section 5(21) of the 'Insolvency and Bankruptcy Code, 2016.

That Hon ble Supreme Court also held in Mobilox Innovations (P) Ltd.

V/s Kirusa Software (P) Ltd. reported in 2018 (1) SCC 353 has held that: -

> 51. 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.
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> 56. Going by the aforesaid test of "existence of a dispute", it is clear that without going into the merits of the dispute, the appellant has raised a plausible contention requiring further investigation which is not a patently feeble legal argument or an assertion of facts unsupported by evidence. The defence is not spurious, mere bluster, plainly frivolous or vexatious. A dispute does truly exist in fact between the parties, which may or may not ultimately succeed, and the Appellate Tribunal was wholly incorrect in characterising the defence as vague, got up and motivated to evade liability.

Thus, it is clear that once an operational creditor has filed an application which is otherwise complete the Adjudicating Authority must reject the application U/S 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, the Adjudicating Authority is to see whether there is a plausible contention which requires further investigation and 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.

In the case in hand, the Respondent lessor has filed the petition for the realisation of enhanced lease rent from the lessee.

Thus understanding for not increasing the rent of a period of 6 years is a question of fact, which requires further investigation. Thus in the present case, there was a pre-existing dispute, which is proved by the issuance of notice under Section 106 of the TP Act, much before the issuance of demand notice, under Section 8 of the I&B Code. Based on the above, the application filed under

Section 9 of the I&B Code could not have been admitted.

We are of the considered opinion that the alleged debt on account of purported enhanced rent of leasehold property does not fall within the definition of the operational debt in terms of Section 5(21) of the Code. On the above basis, it is clear that appeal deserves to be allowed.

ORDER The appeal is allowed and the impugned order dated 21st January 2019 passed by the Adjudicating Authority/National Company Law Tribunal in CP (IB) No. 134/09/HDB/2018 Mr. G. Kishan & Ors. Vs. M/s Walnut Packaging Private Limited is set aside.

In effect, order (s) passed by Ld. Adjudicating Authority appointing „Interim Resolution Professional , declaring moratorium, freezing of account and all other order (s) passed by the Adjudicating Authority pursuant to impugned order and action taken by the „the Resolution Professional , including the advertisement published in the newspaper and all such orders and actions in pursuant to the impugned order are declared illegal and are set aside. The application preferred by the 1st Respondent under Section 9 of the I&B Code is dismissed. The Adjudicating Authority will now close the proceeding. The 5th Respondent Company is released from all the rigour of proceedings and is allowed to function independently through its Board of Directors with immediate effect. The „Interim Resolution Professional /„Resolution Professional will hand over the management and records of the „Corporate Debtor .

The Adjudicating Authority will fix the fee of „Interim Resolution Professional for the period he has functioned, which shall be paid by the applicant. The appeal is allowed with the observation above and direction; there shall be no order as to cost.

[Justice A.I.S. Cheema] Member (Judicial) [KanthiNarahari] Member (Technical) [V. P. Singh] Member (Technical) NEW DELHI 17th January, 2020 pks/md