Whether operational creditor includes a purchaser of goods and services

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Introduction:

In a recent judgment, the Supreme Court of India, while keeping up the efforts of plugging various loopholes in Insolvency & Bankruptcy Code, 2016 ("**Code**"), decided an interesting legal issue relating to the scope of Section 5(20) of the Code, which provides the definition of "operational creditor".

The Apex Court, in the case of **Consolidated Construction Consortium Limited vs. Hitro Energy Solutions Private Limited**,[1] was seized of the following legal questions:

(a) Whether the Appellant is an Operational Creditor under the Code even though it was a 'purchaser';
(b) Whether the Respondent took over the debt from the Proprietary Concern; and
(c) Whether the application under Section 9 of the Code is barred by limitation.

FACTUAL BACKGROUND:

In this case, a project was awarded to a company namely M/s Consolidated Construction Consortium Limited ("**Appellant**") by Chennai Metro Rail Limited ("**CMRL**") for light fittings. The Appellant, in turn, placed three purchase orders, all dated June 24th, 2013, for purchasing the abovementioned product with a sole proprietorship firm M/s Hitro Energy Solutions, ("**proprietary concern**"). The proprietary concern was required to supply the light fittings manufactured by a company M/s Thorn Lighting India Pvt. Ltd. ("**TLIPL**").

On being awarded the purchase orders, the proprietary concern requested the Appellant, for an advance of Rs. 50,00,000/-. On the request of the Appellant, CMRL issued a cheque of Rs. 50,00,000/-, in favour of the proprietary concern as advance payment in lieu of the abovementioned purchase orders.

[1] MANU/SC/0152/2022; Civil Appeal No. 2839 of 2020, decided on February 4th, 2022

Subsequently on January 2nd, 2014, CMRL terminated the contract for light fittings. The Appellant communicated the above fact to the proprietary concern on the same day. The proprietary concern, who, in the meantime had encashed the cheque of Rs. 50,00,000/-, denied the fact that they were informed about the termination on the same day.

Since the contract was terminated, CMRL demanded refund of the amount of Rs. 50,00,000/- paid by them as advance, from the Appellant and also threatened that on Appellant's failure to do so, CMRL would deduct the said amount from the payment of the Appellant, due under some other head. The Appellant, thereafter, immediately refunded the amount of Rs. 50,00,000/- to CMRL from its own sources and intimated the said fact to the proprietary concern. The Appellant also demanded the refund of Rs. 50,00,000/- from the proprietary concern.

In the meantime, on January 28th, 2014, the Respondent company was incorporated and in its Memorandum of Association ("**MoA**"), one of the objects was, "*To take over the existing Proprietorship firm Viz. M/s Hitro Energy Solutions having its registered office at Chennai.*" Since, the aforesaid amount was not refunded by the Respondent, therefore, on July 23rd, 2016, Appellant again requested the Respondent to refund the same, and also undertook to indemnify the Respondent, if at all, CMRL raised any claim against the Respondent for the refund of the amount of Rs. 50,00,000/-.

The Respondent, on July 25th, 2016, denied the request of Appellant on the ground that, they would refund the amount directly to CMRL as they were the ones who had paid the Respondent. The Respondent further stated that the information about the termination of the contract between CMRL and Appellant was received by them, only vide the Appellant's letter dated July 23rd, 2016. Subsequently, in a joint meeting held between the representatives of Appellant, Respondent and TLIPL, the Respondent again agreed to refund the above amount, subject to Appellant arranging a letter from CMRL, to the effect that no claim would be made by them against the Respondent. The Appellant, thereafter, arranged one letter from CMRL, whereby, it was stated that the payment of Rs. 50,00,000/- was made to the Respondent on behalf of Appellant, duly debiting Appellant's account.

However, despite the above, no payment was made by the Respondent and the Appellant, vide its letter dated February 27th, 2017, once again demanded refund of the amount along with the interest @18% per annum. The Respondent, however, vide its reply dated March 2nd, 2017, refused to make any payment, based on a completely new plea that the light fittings ordered by the Appellant were lying in their warehouse completely unused and the same resulted into losses to the Respondent. The Appellant, thereafter, proceeded to issue a demand notice dated July 18th, 2017, under Section 8 of the Code and demanded payment of 'debt' amounting to Rs. 83,13,973/- fallen due and payable as on such date. The Respondent, however, vide its letter dated July 28th, 2017, denied that any debt was payable by them.

Hence, the Appellant filed an application under Section 9 of the Code before the National Company Law Tribunal ("**NCLT**") seeking initiation of Corporate Insolvency Resolution Process against the Respondent.

DECISIONS OF NCLT & NCLAT:

Before NCLT, the Respondent in addition to the contentions mentioned above, also contended that there was no privity of contract between them and the Appellant as the proprietary concern was a separate legal entity. The NCLT, vide its judgment dated December 6th, 2018, rejected the contentions of the Respondent and proceeded to initiate the CIRP of the Respondent.

The Respondent, feeling aggrieved, filed an appeal before National Company Law Appellate Tribunal ("**NCLAT**"). The NCLAT vide judgment dated December 12th, 2019, reversed the judgment of NCLT and held that the Appellant, being a 'Purchaser', cannot be said to be an Operational Creditor under the Code, as it never supplied any goods or provided any services to the Corporate Debtor i.e., the Respondent.

Being aggrieved by the above judgment of NCLAT, the Appellant filed the appeal under Section 62 of the Code before the Supreme Court of India.

FINDINGS AND CONCLUSION BY SUPREME COURT

The Supreme Court discussed various provisions of the Code and various judgments in order to conclude as to what can be considered as an 'Operational Debt' and who can be considered as an 'Operational Creditor' under the Code. The Court *inter alia* examined the provisions contained in Section 5(20) and 5(21) of the Code and concluded that:

- Section 5(21) defines 'operational debt' as a claim in respect of provision of goods and services. The operative requirement is that the claim must bear some nexus with a provision of goods or services, without specifying who is to be the supplier or receiver.
- Perusal of CIRP Regulation 7(2)(b)(i) & (ii), reveals that the regulation is broad enough to include all forms of contracts for the supply of goods and services between the operational creditor and corporate debtor, including the ones who received the goods or services.
- It leaves no doubt that a debt which arises out of advance payment made to a corporate debtor for supply of goods or services would be considered as an ***operational debt***.

  It was, therefore, held that the Appellant was an 'operational creditor' in terms of Section 5(20) of the Code, even if it was a purchaser.

The Court, thereafter, dealt with other contentions of the Respondent and held the following:

- The Court while rejecting Respondent's contention that it suffered losses, held that the Respondent on many occasions agreed to refund the amount of Rs. 50,00,000/- and hence, adverse inference is to be drawn against the Respondent.
- The Court also rejected the contention of no privity of contract between the Appellant and the Respondent on the ground that MoA of the Respondent clearly stated that they intended to take over the proprietary concern and no change or amendment in the same was carried out in terms of Section 13 of the Companies Act, 2013.

- Respondent would be considered as having taken over the proprietary concern in terms of its MoA.
- The Court also proceeded to reject the contention that the debt was barred by limitation. While relying on its earlier judgment in **B.K. Educational Services (P) Ltd. vs. Parag Gupta & Associates**,[2] the Court held that the limitation did not commence when the debt became due but from the date when the default occurred, as the default is defined under Section 3(12) of the Code as the non-payment of the debt by the corporate debtor when it has become due.
- Therefore, the claim of the Appellant was found to be within the period of limitation, on the ground that although the cheque of Rs. 50,00,000/- was issued on November 7th, 2013, but the default occurred on March 2nd, 2017, when the Respondent denied the demand of the Appellant to refund the debt.

Based on the above, the appeal was allowed and the judgment passed by NCLT was upheld by the Supreme Court of India.

The above judgment is another step forward towards filling in the loopholes in the Insolvency Laws by the Supreme Court of India. The Court settled another controversy relating to the operation debt and operational creditors by clarifying that the persons who receive any goods or services, are also operational creditors and not only the suppliers or service providers. It was also reiterated that in order to attract the provisions of the Code, the debt should not only be due, but should also be payable.

[2] (2019) 11 SCC 633