

Unpaid license fees - An ‘operational debt’ under the Insolvency & Bankruptcy Code 2016

I. Introduction

In a move to accord relief to Licensors with outstanding license fee payments, the National Company Law Appellate Tribunal (“NCLAT”) vide order dated 7th July 2022 (“**Order**”) held that a debt arising from unpaid license fees is qualified as an ‘operational debt’ under Section 5(21) of the Insolvency and Bankruptcy Code, 2016 (“**Code**”).

The said order was passed in the case of *Jaipur Trade Expocentre Pvt. Ltd. v. M/s Metro Jet Airways Training Pvt. Ltd.* (“**Jaipur Trade**”) by a 5 (five) member bench of the NCLAT overruling the NCLAT’s previous decisions in the cases of *Mr. M. Ravindranath Reddy v. Mr. G. Kishan & Ors.* (“**Ravindranath Reddy**”) and *Promila Taneja v. Surendri Design Pvt. Ltd.* (“**Promila Taneja**”). In the said order, the NCLAT has observed that the judgments in Ravindranath Reddy and Promila Taneja (which reiterated the stand taken by the NCLAT in Ravindranath Reddy) did not consider the extent and expanse of the expression ‘service’ used in Section 5(21) of the Code. Moreover, the nature of the dues in both the cases was that of rent of immovable property, whereas the present case revolves around outstanding licensee fees arising from a license granted for use of certain premises under a License Agreement that expressly provides for the payment of Goods and Service Tax (“**GST**”). Since the debt arose out of a license granted for a particular kind of service, i.e., running of an educational institution, the unpaid license fee is fully covered under the purview of ‘operational debt’ under Section 5(21) of the Code.

II. Summary of the Order dated 7th July 2022

A. Facts of the case:

- i. The Appellant/Operational Creditor issued a Demand Notice under Section 8 of the Code for total dues of Rs. 1,31,20,788/- (*Rupees One Crore Thirty-One Lakhs Twenty Thousand Seven Hundred and Eighty-Eight only*) against the Respondent/Corporate Debtor. The said debt comprised unpaid license fees under a License Agreement dated 15th April 2017 executed by and between the parties. The Corporate Debtor failed to reply to the contents of the Demand Notice; conversely, the Corporate Debtor initiated civil proceedings before Sanganer Court, Jaipur.
- ii. Simultaneously, the Appellant filed a petition under Section 9 of the Code which was opposed by the Corporate Debtor. Vide order dated

4th March 2020, the Appellant's petition was dismissed on the ground that unpaid license fees do not qualify as an 'operational debt' under the Code. Aggrieved by the said order, the Appellant preferred an appeal before the NCLAT which was later referred to and adjudicated by a five-member bench of the NCLAT.

B. Outcome:

The key issues that arose for determination by the five-member Bench of the NCLAT were as follows:

i. *Whether the judgment in **Ravindranath Reddy** reflects the correct position of law?*

Answering this question in the negative, the NCLAT held as follows:

- a) The facts in Ravindranath Reddy dealt with a demand for enhanced license fees and therefore were distinguishable.
- b) The NCLAT in Ravindranath Reddy did not consider the expanse and scope of the term 'services' under Section 5(21) of the Code and incorrectly relied upon Section 14(2) of the Code which has a very restrictive scope. Section 14(2) of the Code deals with the supply of essential goods or services to the Corporate Debtor and has no nexus to the extent and expense of 'operational debt' within the meaning of Section 5(21) of the Code.
- c) 'Operational Debt' as defined under Section 5(21) of the Code has a much wider meaning than essential goods and services and the Tribunal in Ravindranath Reddy erred in holding that '*any debt arising without nexus to the direct input to the output produced or supplied by the corporate debtor, cannot, in the context of the Code, be considered as an operational debt, even though it is a claim amounting to debt*' - a much wider observation not supported by the scheme of the Code.

ii. *Whether the claim of the unpaid license fee for the use and occupation of immovable property for commercial purposes classifies as an 'operational debt' or not under Section 5(21) of the Code?*

Answering in the affirmative, the NCLAT held as follows:

- a) Section 5(21) of the Code defines an 'operational debt' as a

claim in respect of the provision of goods or services. Except for this definition of ‘operational debt’ as contained under Section 5(21), the term has not been explained under any other provision of the Code. The Bankruptcy Law Reforms Committee Report dated 4th June 2015 cites examples such as outstanding lease rentals qualifying as an operational debt under the Code.

- b) In *Anup Sushil Dubey v. National Agriculture Co-operative Marketing Federation of India Ltd. & Anr.*, the Operational Creditor and Corporate Debtor had entered into a Leave and License Agreement for the use of cold storage. The NCLAT held that lease rental connected with the use and occupation of the cold storage unit qualify as an operational debt. Similarly, in *Sanjeev Kumar v. Aithent Technologies Pvt. Ltd. & Anr.*, where the Operational Creditor had leased certain premises to a Corporate Debtor, the Adjudicating Authority admitted the claim of the Operational Creditor as an unpaid debt which falls under the ambit of Section 5(21). Subsequently, the NCLAT also upheld this order. Another case that concerned the question of unpaid operational debt arising out of a Leave and License Agreement was the case of *Sarla Tantia v. Ramaani Hotels & Resorts Pvt. Ltd. & Anr.* In this case, the NCLAT was of the view that the application under Section 9 of the Code deserves admission. Therefore, a prima facie analysis demonstrates that since the granting of a license to use and occupy premises for a commercial purpose appears to be an operational transaction, the unpaid license fees must be considered an operational debt.
- c) The term ‘services’ under Section 5(21) has not been defined anywhere in the Code. In this regard, the NCLAT relied on the rules of statutory interpretation and observed that the term ‘service’ may be used to refer to any kind of service that is made available to potential users and includes the provision of facilities.
- d) Interestingly, while making a reference to the facts of the case, the NCLAT observed that the Corporate Debtor was liable to GST under the License Agreement and therefore the Appellant was supplying services by granting a license to the Respondent/Corporate Debtor to use and occupy premises. Section 3(37) of the Code stipulates that those words and expressions which have been used but not defined by the Code,

but which may be defined by other statutes shall have the same meanings assigned to them in those statutes. Section 3(37) lists down a specific set of statutes, such as the Companies Act, Indian Contracts Act, etc. However, this does not include the Central Goods and Services Tax Act, 2017 (“CGST”).

- e) Relying on Section 3(37) of the Code, the NCLAT dealt with the observation in **Promila Taneja**, where the Tribunal held that since the Consumer Protection Act, 2019 and Central Goods and Services Tax Act, 2017 have not been expressly covered in Section 3(37) of the Code, the definition of *services* in those statutes cannot be imported relying on Section 3(37) of the Code. The NCLAT denied the argument in **Jaipur Trade** since the License Agreement itself contemplates payment of GST for services rendered under the agreement. Thus, the definition of ‘services’ under the CGST cannot be rendered irrelevant. Moreover, where an expression has not been defined under the statute, its meaning must be ascertained from the general usage and application of the term.

III. Conclusion

The judgment passed by the NCLAT in Jaipur Trade has the effect of widening the scope of Section 5(21) of the Code to include debts pertaining to unpaid license fees. By overruling the order passed in Ravindranath Reddy and consequently Promila Taneja the judgment lays down the latest position of law on the subject which will prevail unless challenged by the Corporate Debtor by way of an appeal to the Hon’ble Supreme Court of India.

The judgment is a welcome move for landlords/licensors seeking respite from the erstwhile tenancy laws which govern tenuous landlord-tenant / licensor-licensee disputes, given the arduous litigation that one would otherwise have to face before a Civil Court even if the debt is an admitted one. At the same time, it is worth considering whether the inclusion of debts which have the potential of being heavily disputed and contested ought to be brought before the National Company Law Tribunals, which are statutorily bound to summarily decide applications filed under the Code.

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