CLAIM FOR REFUND OF ADVANCE: WHETHER AN OPERATIONAL DEBT

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Editor's Note: *The two basic fountainheads of insolvency proceedings under the Code are default of financial debt and operational debt. Operational debt includes a wide range of claimants for supply of goods and services. However, technical issues arise as to whether customer advances constitute operational debt. When entities go insolvent, not only do they have liabilities for goods and services procured, where payments have not been made, but also advances made by customers have not been appropriated by supply of goods and services by the insolvent entity. The term 'operational debt' however includes an amount due against 'provision' of goods or services. Hence arises the ambiguity as to treatment of such consumer advances – as to whether such amounts can be classified as operational debt or not. As noted, determining nature of debt owed to a creditor is instrumental in determination of rights, entitlements, and limitations of the creditor under IBC. There have been certain judicial interpretations concerning the issue – this piece analyses the same*[4].

It is not an unusual business practice to collect advance monies from consumers before providing goods/ services to them. In such a scenario, consumers constantly bear the risk of not being able to recover the amount, in the event the provider of goods/ service suddenly ceases operations and as such, also fails to supply the goods/ services. NCLT, Kolkata, in its recent ruling, in the matter of *SHRM Biotechnologies Private Limited v. VAB Commercial Private Limited*, determined the issue whether claim towards refund of advance money would fall within the definition of "operational debt". The NCLT held in negative, stating that the creditor neither did render any service to the corporate debtor nor did provide any goods to the corporate debtor, and thus, such prepayment would not constitute an operational debt.

> ***"A man who pays his bill on time is soon forgotten"- Oscar Wilde***

Though the said issue has been dealt with in numerous cases, however, due to contradictory stands taken by the NCLT benches, the ambiguity continues. In this article, the authors have tried to analyse the judgment.

Facts of the case

SHRM Biotechnologies Pvt. Ltd., Applicant in the instant case, approached VAB Commercials Pvt. Ltd. ("Corporate Debtor") for arranging for an investor. On the basis of a mandate letter, the Applicant paid certain amount as advance to the Corporate Debtor.

As per the mandate letter, in case the Corporate Debtor is not able to arrange for any investor, the entire advance paid was to be refunded to the Applicant. Despite breach of terms, the Corporate

[4] Contributed on December, 2018.

Debtor did not refund the advance amount. The Applicant contended that the Corporate Debtor has failed to provide requisite services and also, not refunded the advance amount, hence, a demand notice was served on the Corporate Debtor. Further, there was no dispute raised by the Corporate Debtor, and infact, the Corporate Debtor did not turn up before the Adjudicating Authority to contest the application, and therefore, the application should be allowed.

The moot issue for consideration was whether a claim towards repayment of advance, in terms of breach of mandate letter signed and executed by the Applicant and the Corporate Debtor, comes under the ambit of "operational debt", for the purpose of Section 9 of IBC.

Interpretation of the relevant provisions

To determine whether the application is at all maintainable, the Hon'ble NCLT deliberated on the term "operational debt" as contained in IBC. As per Section 5(21), "operational debt" means:

a) claim in respect of provision of-

   i. goods or
   ii. services, including employment; or

b) debt in respect of payment of dues arising under any law for the time being in force and payable to-

   i. the Central Government,
   ii. any State Government; or
   iii. any local authority.

The Applicant could definitely not be categorised as Central Government, any State Government or any local authority. The next question for consideration was whether the debt would fall under the ambit of "claim in respect of the provision of goods or services."

It was observed that the Applicant has not rendered any service, nor provided any goods to the Corporate Debtor. In this regard, the Tribunal also placed reliance on the case of *Sajive Kanwar v. AMR Infrastructure*, wherein NCLT, Principal Bench analysed the definition of operational debt. The relevant extract is as follows:

> *"It is doubtful whether it would include all debts other than financial debt because we do not find any such legislative intendment…"*

Again, in the case of *Daya Engineering Works Pvt. Ltd. v. UIC Udyog Ltd*, the applicant made advance payments for certain materials, for which there was a short supply. An application was, therefore, filed under Section 9, but the matter was dismissed on the ground that the amount due to the applicant did not fall under any of the aforementioned elements of the definition of operational debt, and hence, there exists no operational debt at all.

Our Analysis

To emphasize, the term "operational debt" is defined to mean ***"claim in respect of provision of goods or services…."*** It may be argued that the definition of "operation debt" is ambiguous on two points. First, with regard to the direction of flow of provision of goods or services; the provision does

not stipulate that the provider of goods or services shall be the creditor and the recipient shall be the corporate debtor. An operational debt is only a claim "*in respect of provision of goods or services*". Hence, there might be instances where the party paying advance may be regarded as a creditor, and the party to provide goods/services is then regarded as debtor against the advance amount. Secondly, the section is not very clear as to whether the provision of goods and services should have already taken place on the date of filing of claim, or on the date of making the application, as the case may be, or whether such provision of goods and services may be for future as well.

Considering the aforementioned, it is quite possible to arrive at alternate interpretations of the definition. In fact, in *M/s Auspice Trading Private Limited v. M/s Global Proserv Limited*, a creditor, being aggrieved due to non-repayment of advance, approached NCLT, Mumbai under Section 9 of IBC. The application was admitted by NCLT, initiating corporate insolvency resolution process against the debtor.

To further substantiate, there are potentially three types of claims- financial, operational and others. The category of other claims was added mainly for home buyers, pursuant to the Supreme Court ruling in *Jaypee Infratech*.

It is also pertinent to mention that the erstwhile Section 271(1)(a) of the Companies Act, 2013 for failure to pay money has been deleted, leaving no scope for a winding up application by creditors. In essence, the only remedy seems to be IBC. While it is true that IBC is not a proper remedy for commercial claims; underlying a commercial claim, which is otherwise undisputed, there may be a case of inability to pay or discrete insolvency. But the interpretation of the word "claims", and distinction between financial and operational debt should not be given a narrow interpretation. It is certainly acceptable to construe the term "financial debt" with a precise meaning so as to include financial facilities only, however, the word "operational debt" should be interpreted widely so as to minimise the third category- other claims- which is only a claim without a right. Such a toothless, remediless claim, must be minimised.
