NATIONAL COMPANY LAW APPELLATE TRIBUNAL, NEW DELHI

Company Appeal (AT) (Insolvency) No. 190 of 2017

IN THE MATTER OF:

D Srinivasulu and Anr. **...Appellants**

Vs.

Dr. Reddy's Laboratories Ltd. **...Respondent**

Present: **For Appellants: - Mr. Sourav Roy, Mr. Harsh Anand and Mr. Gaurav Majumdar, Advocates.**

For Respondent: - Mr. M. Rambabu, Advocate.

O R D E R

14.01.2019– This appeal has been preferred by 'D Srinivasulu and Anr.', Director and Shareholder of 'M/s. Inter Labs (India) Private Limited'- ('Corporate Debtor') against the order dated 22nd August, 2017, passed by the Adjudicating Authority (National Company Law Tribunal), Hyderabad Bench, Hyderabad, whereby and whereunder, the application under Section 9 of the Insolvency and Bankruptcy Code, 2016 ("I&B Code" for short) preferred by the Respondents- 'M/s. Dr. Reddy's Laboratories Limited' has been admitted, order of 'Moratorium' has been passed and 'Interim Resolution Professional' has been appointed.

2. On hearing the counsel for the Appellants, this Appellate Tribunal on 19th September, 2017 passed the following orders:

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"19.09.2017 - There is nothing on record to suggest that the Respondent supplied any goods or rendered any services to the Appellant/ 'corporate debtor' within the meaning of Section 5 (20) read with sub-section (21) of the Insolvency & Bankruptcy Code, 2016. This apart, Ld. Counsel for the Appellant submits that there is a 'dispute in existence' prior to the issuance of notice.

Let notice be issued on Respondent. Requisites along with process fee if not filed, be filed by 21st September 2017. If e-mail address of Respondent is provided by the Appellants, notice may also be issued through e-mail. Post the matter on 4th October, 2017."

3. After notice, when the Respondent appeared, just before the same, this Appellate Tribunal rendered a decision in ***"Uttam Galve Steels Limited v. DF Deutsche Forfait AG & Anr. — Company Appeal (AT) (Insolvency) No. 39 of 2017"*** in which this Appellate Tribunal by judgment dated 28th July, 2017 held that notice issued by an Advocate

was not in accordance with the Regulations framed by the 'Insolvency and Bankruptcy Board of India' and by order dated 16th October, 2017 set aside the impugned order dated 22nd August, 2017.

4. The other issue raised by the Appellants was not considered nor deliberated upon by this Appellate Tribunal. The Respondent moved before the Hon'ble Supreme Court against the said judgment in Civil Appeal No. 18831 of 2017 in which the Hon'ble Supreme Court by order dated 24th August, 2018 taking into consideration the decision of the Hon'ble Supreme Court in ***"Macquarie Bank Limited Ltd. vs. Shilpi Cable Technologies Limited– (2018) 2 SCC 674"***, set aside the order passed by us on 16th October, 2017 and remitted the matter for fresh hearing.

5. Learned counsel for the Appellant reiterated his arguments that there was pre-existence dispute and that the Respondent does not come within the meaning of 'Operational Creditor' as defined under Section 5(20) & (21) of the 'I&B Code'.

6. From the record, we find that the Respondent issued one legal notice under Section 433 (e) and 434 of the Companies Act, 1956, by letter dated 5th October, 2016 asking the 'Corporate Debtor' to pay the dues. The 'Corporate Debtor' by its legal reply dated 9th November, 2016, raised dispute relating to late supply of raw material and the poor quality of products and made counter claim. The relevant portion of the letter

written by the 'Corporate Debtor' on 9th November, 2016, reads as follows:

10. That our client had already informed your client vide its letter dated November 27, 2013 that our client was in severe losses and was in poor financial health mainly due to your client's failure to provide raw materials which is your client's obligation under the terms of the Agreement for the manufacture of the Q-Acid. That without the raw materials it was practically impossible to deliver the Q-Acid to your client. That our client's plant was designed in such a way that 80% of the equipment at our client's facility was designed and utilized for manufacturing Q-Acid and without manufacturing Q-Acid our client was unable to make other products as it was not viable. Therefore our client had a total plant capacity of 32-35 MT for production of Q-Acid per month and a capacity of only 2–3 tonnes for production of other product and hence our client's plant is not viable without production of Q-Acid.

11. That our client had also given you illustrative explanation vide its letter dated November 2013 that if our client were to take the date for the last 18 months the plant was running on and off and at times plant was shut down continuously for 50-60 days at a stretch. There were many instances that because of your client's failure to provide one or two raw materials the entire plant was closed for 5-10 days and this shut down

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has occurred a number of times. Your client is even aware that the plant was closed over a few months due to non-availability of raw materials. Our client is a very small company and is a Small Scale Industry and it had limited sources of finance and had already exhausted its working capital. Because of non-availability of raw materials, and due to shutting down of the plant a number of times our client was incurring more and more yield loss. As on November 2013 our client had a total strength of about 120 people working with our client and our client was solely dependent on your client for the job work arrangement and on several occasions and sometimes for months together our client's plant and all the staff were lying idle and incurring more and more loss. This resulted in a shut-down of the plant for around 4-5 months in the years 2011-2013 and our client incurred an approximate loss of Rs. 3,00,00,000/- as on November 2013.

12. Thereafter, your client made several requests to our client and promises to make up for the losses by placing fresh orders on our client for the manufacture of Q-Acid and your client promised that it was not in a state to supply raw material to our client and that it would support our client in procuring raw materials from a third party. While Clause 22(4) of the Agreement specifically provided that in case any modification is made to the Agreement the same shall be in writing to make such modification binding, till date no amendment was made to the Agreement to record that your client was not capable of supplying raw material and our client had to incur fresh liability by approaching a third party to procure raw materials. Hence in view of no amendment to the Agreement, till date it is your client's obligation to supply the raw materials and your client is in serious breach of its obligations till date. All through the term of the Agreement, till the date of termination of the Agreement and till the date of receipt of your Notice your client has been constantly arm-twisting and putting our client's very existence in serious and grave jeopardy.

13. Therefore, since the time of entering into the Agreement your client was required to place an order of 3600 tonnes of Q-Acid from June 2007 up to May 2017. However, against this number, your client has actually placed an order of 1294 tonnes of Q-Acid from June 2007 to September 2016. That your client has also defaulted in providing regular supply of raw materials as per the terms of the Agreement. In fact as of March 31, 2014 our client was already suffering severe losses to the tune of Rs. 4,00,00,000/- because of your client and your client kept breaching the terms of Agreement and was pressurising our client to supply Q-Acid out of small quantities of raw materials. Your client's continuous breach of terms of Agreement was resulting in negative economies of scale and the conversion cost over small quantities was simply not adequate to keep the facility running twenty four seven at your clients beck and call.

14. That our client was shocked to receive a termination notice dated September 29, 2016 which stated that, "*we hereby termination this Agreement by invoking Article 20 of the Agreement with effect from 04.07.2016.*" This termination notice is patently illegal and is squarely in violation of Clause 20(2) of the Agreement which requires that the Agreement may be terminated by either of the parties with a prior written notice of ninety (90) days i.e. January 1, 2017. Therefore the loss incurred by our client from June 2007 up to January 2017 is Rs. 28,80,00,000/- because of your client's failure to place purchase orders for 30MT of Q-Acid per month and even for whatever orders were placed for little quantities of Q-Acid, not supplying raw materials.

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Partner

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15. That said loss is calculated in accordance with Annexure II to the Agreement which specifically provides that the mark up (conversion) is Rs. 90 per kg and calculated till last conversion charges paid by your client Rs.160 per kg and the average conversion charges Rs.125/-per kg of Q-Acid and against 2306 MT i.e. 30MT per month from June 2007 up to January 2017.

16. In view of the aforesaid, our client was suffering severe losses because of reasons solely attributable to your client and hence any claim for amounts from our client is subject to payment of amounts which are outstanding and which have become legally due and payable by your client to our client.

7. Learned counsel appearing on behalf of the Respondent-'Operational Creditor' submits that prior to the dispute raised by letter dated 9th November, 2016, the 'Corporate Debtor' had agreed to pay the amount by letter dated 4th July, 2016. Further, according to him, there is no suit pending nor any arbitration proceeding pending against the 'Operational Creditor'. However, it is not denied that the dispute relating to quality of raw material and loss was raised by the 'Corporate Debtor' on 9th November, 2016 i.e. much prior to the issuance of the demand notice dated 18th March, 2017 issued under Section 8(1).

8. In the aforesaid background, as we find that there is pre-existence dispute prior to the issuance of the demand notice under Section 8(1), we hold that the application under Section 9 of the 'I&B Code' preferred by the Respondent was not maintainable. The impugned order dated 22nd August, 2017 is accordingly set aside.

9. In effect, order (s), passed by the Adjudicating Authority appointing any 'Interim Resolution Professional', declaring moratorium,

freezing of account, and all other order (s) passed by the Adjudicating Authority pursuant to impugned order and action, if any, taken by the 'Interim Resolution Professional', including the advertisement published in the newspaper calling for applications all such orders and actions are declared illegal and are set aside. The application preferred by Respondent under Section 9 of the 'I&B Code' is dismissed. Learned Adjudicating Authority will now close the proceeding. The 'Corporate Debtor' (company) is released from all the rigour of law and is allowed to function independently through its Board of Directors from immediate effect.

10. The Adjudicating Authority will fix the fee of 'Interim Resolution Professional' and the 'Corporate Debtor' will pay the fees of the 'Interim Resolution Professional', for the period he has functioned. The appeal is allowed with aforesaid observation. However, in the facts and circumstances of the case, there shall be no order as to cost.

(Justice S.J. Mukhopadhaya)
Chairperson

(Justice Bansi Lal Bhat)
Member(Judicial)

Ar/G