

# Supreme Court on residual power of NCLT to adjudicate contractual disputes

08 December 2021

In *Tata Consultancy Services Ltd. v. Vishal Ghisulal Jain, RP, S.K. Wheels Pvt. Ltd. (TCS case)*, the Supreme Court considered the issue of exercise of residuary jurisdiction by the National Company Law Tribunal (NCLT) under section 60(5)(c) of the Insolvency and Bankruptcy Code, 2016 (IBC) over contractual disputes of the corporate debtor.

On 23 November 2021, a division Bench of the Supreme Court in the TCS case clarified the position taken by the Supreme Court in an earlier decision of *Gujarat Urja Vikas v. Amit Gupta & Ors. (Gujarat Urja case)*. It held that the NCLT under section 60(5)(c) of the IBC can restrain a party from terminating a contract only if such termination arises solely from or relates to the insolvency of the corporate debtor. Even if a contractual dispute arises in relation to the insolvency, a party can be restrained only if the contract is central to the success of the corporate insolvency resolution process (CIRP) i.e. only if such termination is likely to hamper the functioning of the corporate debtor as a going concern. If the termination is on any ground unrelated to the insolvency, the NCLT cannot exercise its residuary jurisdiction to adjudicate the contractual dispute.

In its recent ruling, the Supreme Court has clarified the position taken in its earlier decision of *Gujarat Urja Vikas v. Amit Gupta & Ors.* that the NCLT can use its residuary jurisdiction under the IBC only to adjudicate contractual disputes that relate to insolvency and more importantly, only if such disputed contract is central to the insolvency resolution process.

## 1 Background

Tata Consultancy Services (**Appellant**) entered into a contract with S. K. Wheels Private Limited (**Corporate Debtor**) requiring the Corporate Debtor to provide premises with certain specifications and facilities to the Appellant for conducting examinations for educational institutions. The contract included a termination clause for any material breach of the contract by written notice to the party in breach allowing it a month's time to cure the breach.

The Appellant terminated its contract with the Corporate Debtor citing various material breaches and lapses in the quality of services provided to it, with no satisfactory remediation. However, this was disputed by the Corporate Debtor which claimed that all defects were cured within a reasonable time and the Appellant terminated the contract with immediate effect without serving due notice. Meanwhile, before the termination of the contract, a CIRP had been initiated for the Corporate Debtor and the Appellant could not initiate any recovery proceedings for the losses sustained by it due to imposition of moratorium on the Corporate Debtor under section 14 of the IBC.

## 2 Proceedings before the NCLT and the NCLAT

The Corporate Debtor filed a miscellaneous application before the NCLT under section 60(5)(c), seeking to quash the termination notice.

The NCLT granted an ad-interim stay on the termination notice directing the Appellant to comply with the terms of the agreement and make payments to the Corporate Debtor. This order was passed by the NCLT on a *prima facie* view that the contract was terminated without serving the requisite notice of thirty days.

Upon appeal, the NCLAT upheld the impugned order.

## 3 Supreme Court's decision

In addition to the contested facts leading up to the issuance of the termination notice, the core issues arising for consideration before the Supreme Court were two pronged.

- a. Whether the NCLT can exercise its residuary jurisdiction under Section 60(5)(c) of the IBC to adjudicate the contractual dispute between the parties; and
- b. Whether in the exercise of such a residuary jurisdiction, it can impose an ad-interim stay on the termination of the contract.

After examining the facts of the case, the Court held that there was nothing to indicate that the termination of the contract was motivated by the insolvency of the Corporate Debtor. Therefore, NCLT will not have residuary jurisdiction under Section 60(5)(c) of the IBC to adjudicate the contractual dispute which has arisen dehors the insolvency of the Corporate Debtor. In the absence of such jurisdiction the NCLT could not have imposed an ad-interim stay on the termination notice.

Expounding on its decision, the Court held that Section 60(5)(c) grants residuary jurisdiction to the NCLT to adjudicate any question of law or fact, arising out of or in relation to the insolvency resolution of the Corporate Debtor and not when the dispute has no connection or is unrelated to the insolvency. It observed that the Appellant had time and again informed the Corporate Debtor of the deficiency in its services and that it was falling foul of its contractual obligations. Further, no motivation could be attributed to the Appellant for terminating the contract on the ground of the insolvency of the Corporate Debtor. The Court therefore found no nexus between the contract termination and insolvency of the Corporate Debtor.

The Court cautioned the NCLT and the NCLAT in the use of their powers causing interference with a party's contractual right to terminate a contract. The Court held that even where a contractual dispute arises out of or relates to the insolvency, the NCLT/NCLAT can only interfere with a party's right to terminate a contract, if it is 'central to the success of the CIRP' - crucially, the termination of the contract should result in the 'corporate death' of the corporate debtor.

The Court found that in the TCS case, the NCLT had not applied its mind to the centrality of the contract for the success of the CIRP and Corporate Debtor's survival as a going concern. Instead, it merely relied upon the procedural infirmity on part of the Appellant in the issuance of the termination notice. The NCLAT, in its impugned judgment, also erroneously averred that the decision of the NCLT preserves the 'going concern' status of the Corporate Debtor without a factual analysis on how the termination of the contract would threaten the survival of the Corporate Debtor.

The Supreme Court, while deciding on the use of NCLT's residuary powers to adjudicate contractual disputes between parties under section 60(5)(c) of the IBC, has provided much-needed clarity on how the Gujarat Urja case

## UPDATES

is to be correctly interpreted. Fetters to an authority's discretionary or residuary powers are the hallmark of the rule of law and the Supreme Court has upheld this basic principle in the TCS case.

Additionally, the Supreme Court recognises that the NCLT does not have jurisdiction under the IBC to adjudicate contractual disputes that are unrelated to the insolvency. Therefore, to ring-fence a contractual dispute from being brought within the NCLT's residuary powers of adjudication, businesses should document deficiencies in performance and any breach of contractual obligations in sufficient detail, giving a clear and cogent account of events so that any termination of contract is not seen as a smokescreen to terminate on the grounds of insolvency of a counter party.

This verdict is bound to have a significant impact given the rising number of CIRPs, especially in a post-pandemic era. It will be interesting to see how the NCLT and NCLAT will apply this judgment while exercising their residuary powers going forward.

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