

October 2022

## **NCLAT: Claims arising from the grant of an exclusive right and license to use intellectual property rights constitute an 'operational debt' under the IBC**

In the recent decision of *Somesh Choudhary v. Knight Riders Sports Private Limited & Ors.*<sup>1</sup>, the National Company Law Appellate Tribunal (“NCLAT”), New Delhi has held that claims arising from the grant of an exclusive right and license to use intellectual property rights falls within the definition of “operational debt” under Section 5(21) of Insolvency and Bankruptcy Code, 2016 (“IBC”).

### **Background Facts**

Global Fragrance Private Limited (“GFPL”/ “Appellant”) and Knight Riders Sports Private Limited’s (“KRSPL”/ “Respondent”) entered into a licensing agreement whereby KRPSL permitted GFPL to (a) use the Respondent’s intellectual property rights i.e., the trademark “Kolkata Knight Riders” and “KKR” and (b) use, manufacture, sell, distribute and advertise the licensed products (“Agreement”). In return, GFPL was obligated to pay minimum guaranteed royalties (“MGR”) to KRSPL.

Under the Agreement, KRSPL raised invoices towards MGR payable by the GFPL. GFPL only made part payment of the invoice received, and the balance amounts remained unpaid. Accordingly, KRSPL filed a Section 9 petition under IBC.

GFPL opposed the petition on the ground that claims arising out of non-payment of MGR were not ‘operational debt’ as it did not pertain to “any goods and services”. GFPL further referred to the decision in *M. Ravindranath Reddy v Mr. G. Kishan & Ors.*<sup>2</sup> wherein the NCLAT had held that any debt which arises without nexus to the direct input to the output produce or supplied by a corporate debtor, cannot be considered as an ‘operational debt’. On the basis thereof, GFPL submitted that KRSPL has failed to establish that GFPL used the trademark of the KRSPL for the sales, marketing, etc. and therefore, GFPL’s claim for non-payment of MGR does not constitute ‘operational debt’.

NCLT, Delhi admitted the Section 9 petition under IBC against GFPL. Aggrieved, the shareholders of GFPL filed an appeal.

### **Issue**

Whether the payment of MGR under an intellectual property license agreement constitutes an ‘operational debt’ under Section 5(21) of the IBC.

<sup>1</sup> Company Appeal (AT) (Insol.) No.501 of 2021, judgement dated August 18, 2022

<sup>2</sup> Company Appeal (AT) (Ins.) No. 331/2019

## Position of law

Under Section 5(21) of the IBC, an ‘operational debt’ means a claim in respect of the provision of goods or services including employment or a debt in respect of the payment of dues arising under any law for the time being in force and payable to the Central Government, any State Government or any local authority.

## Findings and Rationale of NCLAT

1. **“Goods” under Section 5(21) of the IBC:** The Tribunal held<sup>3</sup> trademarks and copyrights constitute movable property and would accordingly be considered “goods” under the Sale of Goods Act, 1930<sup>4</sup>.
2. **Meaning of MGR:** A guaranteed minimum annual royalty or guaranteed minimum royalty, is a payment made periodically by a licensee to a licensor pursuant to a license regardless of sales success for a licensed product over that year. Unlike a royalty which is usually calculated as a percentage of net sales revenue, a minimum royalty is generally an agreed lump-sum payment of reasonably expected revenue from the sale of a licensed product over the agreed time period.
3. The NCLAT relied upon its larger bench decision to apply that if an expression is not defined in the statute, the meaning of the expression in general parlance has to be considered for meaning and purpose of expression.
4. **MGR as “goods”:** Since “goods” under Sale of Goods Act, 1930 includes all moveable properties other than actionable claims and money, MGR also constitutes a “good”.
5. **Licensing of intellectual property rights in return for MGR as an “supply of service”.**
  - (a) Under Section 7 of the Central Goods and Service Act, 2017, any utilization or enjoyment of intellectual property rights would be considered a service provided by the intellectual property rights holder.
  - (b) The Madras High Court in the judgement of *AGS Entertainment Private Limited v. Union of India*<sup>5</sup> has held that temporary transfer/permission to use the copyright constituted a provision of service by the owner of the copyright to the other person.
6. **Licensing ‘KKR’ in return for MGR as an “Operational Debt”.**
  - (a) GFPL was permitted to use the trademark of ‘KKR’ in relation to its licensed products, hence, there was a temporary transfer/permission to use of the trademark, constituting a ‘provision of service’. Therefore, this falls within the definition of ‘service’ and any amounts which are ‘due and payable’ arising out of such service is an ‘operational debt’.
  - (b) Moreover, the invoices raised by KRSPL on GSPL contemplate the payment of goods and services tax for the use of the service and therefore, the definition of ‘service’ under the Goods and Services Tax Act, 2017 also becomes applicable to the facts of this case.
7. In view of the above, the NCLAT found that the claim of the licensor for payment of license fee constitutes an ‘operation debt’ under the IBC. The NCLAT then considered and concluded that there a ‘debt’ and ‘default’ by GFPL, and there was no ‘pre-existing dispute’. Accordingly, the NCLAT upheld the decision of the NCLT and dismissed the appeal.

<sup>3</sup> The NCLAT relied upon the decision of *Vikas Sales Corporation v. Commissioner of Sales Tax, (19996) 4 SCC 433*, wherein the Supreme Court observed that “even incorporeal rights like trademarks, copyrights are ‘moveable property’ and are included in the ambit of ‘goods’ under the provisions of Sales of Goods Act, 1930.”

<sup>4</sup> Section 2(7) of the Sales of Goods Act, 1930 defines “goods” to mean every kind of movable property other than actionable claims and money; and includes stock and shares, growing crops, grass, and things attached to or forming part of the land which are agreed to be served before sale or under the contract of sale.

<sup>5</sup> *AGS Entertainment Private Limited v. Union of India*, 2013 SCC Online Mad 1823

## JSA Comment

1. This is a significant decision with a direct impact on tech companies, start-up and larger multi-national companies across sectors which have been routinely using intellectual property rights, as well as technology rights, as security to their debt. With this decision, the obligation and responsibility to honour these commitments have become paramount, since the consequent liability thereof is the risk of liquidation process being initiated by the lenders against these companies.
2. This judgement clearly lays down that temporarily licensing of intellectual property rights amount to a 'provision of service' and accordingly, non-payment of such license would constitute an 'operational debt' for the purposes of the IBC.

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