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The arbitration and insolvency collision: the Indian Perspective

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The interplay of arbitration and insolvency has assumed greater significance in recent times with the evolution of new insolvency regime in India. With limited statutory guidance available on this subject, many arbitral proceedings have been stalled due to the onset of insolvency proceedings. While some jurisdictions have settled the position of law in this regard, India is relatively a new entrant to the list.

India underwent a sea change in the insolvency regime in 2016, with the enactment of the Insolvency and Bankruptcy Code, 2016 ('Code'). As such, there are no provisions in the Code which stipulates the impact of the insolvency proceedings on an arbitration, except, imposition of a moratorium. The Indian Arbitration and Conciliation Act, 1996 ('Arbitration Act'), too, does not stipulate the effect or impact of corporate resolution insolvency process ('CIRP') or liquidation under the Code. These issues will assume even more significance as the world grapples in the post-Covid era, with the onset of more commercial disputes.

With no clarity on laws and judicial precedents, this has evolved as a grey area with parties facing diverse issues, including fresh initiation or continuation of the arbitration proceedings, the impact of insolvency proceedings on a foreign seated arbitration, the ability to participate in the insolvency resolution process, the enforcement of arbitral award vis-a-vis such proceedings. Both the laws are seen to be at loggerheads with no clarity on their intersection. It has been aptly explained in a US court ruling to state that 'a conflict of near polar extremes: bankruptcy policy exerts an inexorable pull towards centralization while arbitration policy advocates a decentralised approach towards dispute resolution.'**[i]**

The effects of insolvency on pending arbitration proceedings completely stall the proceedings in India whereas it could also lead to modification in proceedings in other jurisdictions. The objective of the article is to delve into some of these aspects with the aim to identify issues and suggest solutions to balance these conflicting interests.

How does the Code operate?

The Code was introduced to 'consolidate and amend the laws relating to reorganisation and insolvency resolution of corporate persons in a time bound manner for maximisation of value of assets of such persons to promote entrepreneurship, available of credit and balance the interest of all the stakeholders.' Under the Code, a financial **[ii]** or operational creditor**[iii]** having outstanding dues of at least INR [1 crore]**[iv]** equivalent to USD 137,300 or a corporate debtor who has defaulted on payment of debts to its creditors can seek to initiate CIRP over a corporate debtor by filing an insolvency application before a National

Company Law Tribunal ('NCLT')[v], also known as the Adjudicating Authority under the Code. If the NCLT finds that a default in payment of the said debt exists, the NCLT can direct the initiation of CIRP over the corporate debtor and appoint an Interim Resolution Professional (later replaced by a Resolution Professional) to manage the affairs of the corporate debtor during the CIRP period. Post declaration of the default, a public announcement[vi] is made under the Code, and a moratorium is declared prohibiting, amongst others, the institution or continuation of suits or other proceedings against the corporate debtor and transferring / encumbering / disposing of the corporate debtor's assets. The CIRP (once commenced) is not arbitrable (at least during the pendency of the insolvency resolution process). The Supreme Court in *A. Ayyasamy vs A. Paramasivam & Ors*[vii] has observed that 'insolvency and winding-up matters' are not arbitrable. The order of moratorium is valid until completion of the CIRP.[viii]

Scope of moratorium imposed under the Code

The moratorium specifically bars 'the institution of suits or continuation of pending suits or proceedings against the corporate debtor including execution of any judgement, decree or order in any court of law, tribunal, arbitration panel or other authority'.[ix] Opening of an insolvency proceeding also bars enforcement action in India. The judicial pronouncements have clarified the scope of the moratorium –(i) asset maximisation and (ii) ensuring that the assets of the corporate debtor are not adversely impacted.

In fact, the Supreme Court in *Alchemist Asset Reconstruction Company*[x] held that arbitrations or related proceedings commenced after initiation of CIRP are considered non-est in law. However, although there exist no statutory exceptions, the judicial precedents have created certain exceptions against the general rule. The courts have allowed continuation of the arbitration proceedings provided: (i) they maximise the value of the assets of the corporate debtors; (ii) the proceedings are beneficial to the corporate debtor and do not adversely impact the assets of the corporate debtor[xi] or (iii) even if proceedings are allowed to be continued no recovery can be pursued against the corporate debtor during the operation of the moratorium period.[xii] Courts have also refused to stay claims/counter-claims against a corporate debtor if it was found that the corporate debtor did not face any adversity until the claims/counterclaims are adjudicated upon.[xiii] Pending legal proceedings which had been stayed due to the operation of the moratorium order can be re-instated once the CIRP is successfully completed as the moratorium is lifted post completion of CIRP, as well as on the commencement of liquidation proceedings.

The position of law varies slightly in case a liquidation is initiated. When a liquidator is appointed, there is a bar against initiation of a suit, or other legal proceeding by or against a corporate debtor during the liquidation proceedings. However, a suit or other legal proceedings may be initiated by the liquidator on behalf of the corporate debtor with prior approval of NCLT.[xiv] Therefore, pending legal proceedings (which would also include arbitration proceedings) are technically not barred in the event of liquidation of the corporate debtor.

Impact of the moratorium order on arbitration proceedings

The law does not differentiate between arbitration proceedings which are pending, and the ones commenced after the opening of insolvency proceedings. It does not provide any specific statutory procedure for overcoming the moratorium imposed by the Code for initiation or continuation of arbitration. However, if one can demonstrate that an arbitration is initiated for the benefit of the corporate debtor, maximise the corporate debtor's assets or

one that would not adversely affect the corporate debtor's assets, an arbitrating party may be able seek continuation of the arbitration proceedings. A NCLT ruling in this regard would render clarity.

All India seated arbitrations have to comply with the moratorium order passed by the NCLT. In a foreign seated arbitration involving an Indian party which is subjected to the insolvency proceedings, such party can apply before the foreign seated arbitral tribunal and request a stay on the arbitration proceedings. One can state that the language in Section 14 of the Code i.e., 'the institution of suits or continuation of pending suits or proceedings against the corporate debtor including execution of any judgement, decree or order in any court of law, tribunal, arbitration panel or other authority' is broad, and would be applicable even in a foreign seated arbitration as well.

However, if a foreign seated arbitration award can be enforced against the foreign assets (outside India), then there may not be any real prejudice as the award need not have any nexus with the law of India. This is on the basis that India has not yet notified the reciprocating territories under Section 234 of the Code, and therefore, unless the courts at the seat of the arbitration recognize the insolvency proceedings, there may not be any bar in continuation of such arbitral proceedings. Should the tribunal not adhere to the moratorium order passed by the NCLT, there may be challenges in enforcement of such award at least in India, as enforcement will be resisted on the grounds of public policy.

Can a party to the arbitration proceeding file a claim in the CIRP?

A claim under the arbitration agreement is not specifically covered under the definition of a debt under the Code. However, if the claim independently falls within the purview of the 'financial' or 'operational debt' under the Code, the same can be filed by a creditor before the Interim Resolution Professional. If the claim is not included, the creditor has the option to take recourse before the NCLT and agitate the non-inclusion of such claims. The NCLT can either agree to include the claim as list of credit or reject the plea. If the NCLT still refuses it, the claim is confirmed as pending dispute in the information memorandum. Further such claims are categorized as a pending litigation/ dispute, and treatment of such claims are dependent entirely on the discretion of the incoming investor (Resolution Applicant). In most cases, nil value is assigned to such claims, or the Resolution Plan will provide for a clause which stipulates that all pending litigation/ dispute resolution claims will stand extinguished as soon as the CIRP is completed. The Supreme Court's ruling in the Essar Steel**[xv]** has also affirmed that the successful Resolution Applicant must take over the corporate debtor without any antecedent liabilities.

Is an arbitral award a valid proof of debt under the Code?

An arbitral award can be used to initiate insolvency proceedings, provided the credit therein must be undisputed. The Supreme Court in **K. Kishan v. M/s Vijay Nirman Company[xvi]** affirmed that even though arbitral awards are valid records of an operational debt, the same would have to be undisputed in order to enable initiation of the CIRP by operational creditors. The Supreme Court refused entertaining the corporate insolvency resolution process on the premise (a) that a counterclaim exceeding the claim awarded was rejected by the Arbitral Tribunal on merits, and such rejection is also a matter of challenge before the Courts; and (b) a challenge had also been filed against the Arbitral Award.

In case of a foreign award, it needs to meet the two-fold test of recognition and enforcement

under Part II of the Arbitration Act. There are a series of cases by the Indian Supreme Court which have recognized that a foreign award has different stages: in the first stage, the Court would decide about the enforceability of the award having regard to the requirements of Section 47 and 48 of the Arbitration Act. Upon recognition of the foreign award, and if such award is not resisted during enforcement (if the award faces resistance during enforcement proceedings, then it would become disputed), it may be treated as an operational debt. Once the enforceability of the foreign award is decided, it would proceed to take further effective steps for execution of the award.**[xvii]**

However, the Mumbai bench of NCLT in *Agrocorp International Private (PTE) Limited v. National Steel and Agro Industries Limited***[xviii]** has taken an opposite view and has held that enforcement of a foreign award is not required for successfully maintaining an insolvency claim against the corporate debtor. In this case, the foreign award was not challenged**[xix]**, and that was used as a basis to admit the insolvency petition. The NCLT decided on the premise that a foreign award so long as it has attained finality at the seat of arbitration, is a valid proof of debt, and therefore, can be used by a foreign creditor to initiate insolvency proceedings in India. One may argue in support of the decision and contend that a foreign award so long as it has attained finality at the seat of arbitration, is a valid proof of debt, and therefore, can be used by a foreign creditor to initiate insolvency proceedings in India. It remains to be seen whether an appeal against the judgment of the NCLT is filed before the National Company Law Appellate Tribunal ('NCLAT'), and how they decide this issue.

Does the Code prevail over the Arbitration Act or is the other way around?

The NCLT in a recent decision of *Kotak India Venture Fund- I v Indus Biotech Private Limited***[xx]** referred parties to arbitration during the pendency of insolvency proceedings and dealt with the pivotal issue of which statute prevails in case of a conflict. Relying on the age-old principle of special law prevailing over general law, the NCLT held that in case of contractual dispute between parties with an arbitration clause, arbitration would prevail over insolvency proceedings and prevent solvent companies facing CIRP. Initiating dressed up insolvency petitions have been prevalent to avoid arbitration proceedings and prevent parties from adjudicating the dispute or as a pressure tactic but applying it uniformly may not serve the purpose in all circumstances. The arbitrability of insolvency petitions still remains a grey area in India with no clear answers due to contradictory rulings and lack of a Supreme Court ruling on this issue.

Road Ahead

Due to the onset of Covid-19, the Code was suspended for a period of one year with effect from 25 March 2020. We have interesting times ahead of us, with the suspension soon to be lifted monitoring the progress of insolvency proceedings post Covid-19 and its impact on arbitration proceedings. There is a need to strike a delicate balance in respect of providing a clean slate to the new management (incoming investors) upon successful completion of CIRP, and extinguishment of legal rights of the parties to the legal proceedings (including arbitration proceedings) who are disentitled to pursue their claim due to the imposition of the moratorium order and subsequently, on approval of the Resolution Plan.

Despite the corporate debtor being rescued, it practically translates in nil payment being awarded to the parties to the arbitral proceedings, leaving parties remediless. As businesses fail due to the impact of the pandemic, unless the law is addressed properly, we will see an increase in the number of cases where arbitral proceedings will be marred due to the onset

of insolvency proceedings against the corporate debtor, impacting investor confidence in enforcing contracts and ease of doing business in India.

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[i] In Re United Stated Lines Inc. 197 F.3d 631 (2nd Cir. 1999)
[ii] Section 5 (7) of the Code defines a 'financial creditor' as "…means any person to whom a financial debt is owed and includes a person to whom such debt has been legally assigned or transferred to". Financial Debt is defined in Section 5 (8) of the Code and means "…a debt alongwith interest, if any, which is disbursed against the consideration for the time value of money and includes - (a) money borrowed against the payment of interest; (b) amount raised by acceptance under any acceptance credit facility or its de-materialised equivalent; (c) amount raised pursuant to any note purchase facility or the issue of bonds, notes, debentures, loan stock or any similar instrument;…".
[iii] Section 5 (20) of the Code defines an "operational creditor" as "…a person to whom an operational debt is owed and includes any person to whom such debt has been legally assigned or transferred…". Section 5 (21) of the Code defines an "operational debt" as "…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…".
[iv]Notification under Section 4 of the Code, available on **https://ibbi.gov.in//uploads/legalframwork/48bf32150f5d6b30477b74f652964edc.pdf**.
[v] Sections 7, 9, 10 of the Code.
[vi] Section 5(12) of the Code- "insolvency commencement date" means the date of admission of an application for initiating corporate insolvency resolution process by the Adjudicating Authority under sections 7, 9 or section 10, as the case may be:
[vii] (2016) 10 SCC 386
[viii] Section 14(4) of the Code: The order of moratorium shall have effect from the date of such order till the completion of the corporate insolvency resolution process:

Provided that where at any time during the corporate insolvency resolution process period, if the Adjudicating Authority approves the resolution plan under sub-section (1) of section 31 or passes an order for liquidation of corporate debtor under section 33, the moratorium shall cease to have effect from the date of such approval or liquidation order, as the case may be.
[ix] K.S. Oils Ltd v. The State Trade Corporation of India Ltd & Anr., Company Appeal (AT) (Insolvency) No. 284 of 2017.
[x] Alchemist Asset Reconstruction Company Ltd v. Hotel Gaudayan Pvt Ltd. AIR 2017 SC 5124.
[xi] Power Grid Corporation of India Ltd. v. Jyoti Structures Ltd. 246 (2018) DLT 485.
[xii] Jharkhand Bijli Vitran Nigam Limited v IVRCL Ltd. (Corporate Debtor) & Anr. [Company Appeal (AT)(Insolvency) No. 285 of 2018.
[xiii] SSMP Industries Ltd. v. Perkan Food Processors Pvt. Ltd., CS (COMM) 470/2016 & CC(COMM) 73/2017.
[xiv] Section 33(5) of the Code: Subject to section 52, when a liquidation order has been passed, no suit or other legal proceeding shall be instituted by or against the corporate debtor:

Provided that a suit or other legal proceeding may be instituted by the liquidator, on behalf of the corporate debtor, with the prior approval of the Adjudicating Authority,
[xv] Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta & Ors (2019) SCC OnLine SC 1478.

[xvi] K. Kishan v. M/s Vijay Nirman Company Pvt. Ltd and M/s Ksheerabad Constructions Pvt. Ltd. Civil Appeal No. 21825 of 2017.

[xvii] Fuerst Day Lawson Ltd v. Jindal Exports (2001) 6 SCC 356; Government of India v. Vedanta Limited & Ors, SLP (Civil) No. 7172 of 2020.

[xviii] CP (IB) No. 798/ MB/ C-IV/ 2019

[xix] Ibid at Paragraph 37: "…This Bench is of the considered view that it is not possible to wait indefinitely for the Corporate Debtor to challenge the Arbitral Award, and that it has to decide the present petition on the basis of the admitted positions, that is to say, there is an Arbitral Award passed by a competent Arbitral Tribunal after the consideration of the positions of both the sides, and there is no challenge to the Arbitral Award dated 16.04.2018 in a manner known to law. Hence the same cannot be considered as a pre-existing dispute, and the objection of the Learned Counsel for the Corporate Debtor on this count is rejected…".

[xx] CP (IB) No.3077/2019