Arbitration and Insolvency at the Crossroads?

Economic stress, compounded by the COVID-19 pandemic, is likely to increase the number of commercial disputes and insolvencies in India. As a result, in the years to come, many parties may find themselves pondering whether to file for recovery of their claims through the dispute resolution mechanism specified in their contract (often, arbitration), or initiate action under the Insolvency and Bankruptcy Code, 2016 (IBC).

It is often the case that the law of arbitration and law relating to insolvency are at the loggerheads with respect to the impact of insolvency proceedings on arbitration or the enforcement of an arbitral award *vis-à-vis* insolvency proceedings. Since the statute guidance on this aspect is limited and the judicial position is still evolving, it would be interesting to see how jurisprudence pertaining to these aspects unfold.

Having stated the above, it is not always easy to reconcile the approach under arbitration and insolvency laws. The inherent nature of arbitration is that the dispute is resolved *inter se* parties, which is different from the law of insolvency, where once the process is initiated and accepted, the claims of all creditors are resolved and a resolution plan with respect thereto is formulated. The resolution plan formulated during the insolvency proceedings aims to maximise the assets of the corporate debtor, and the resolution plan would override any contractual obligations or agreements that the company had prior to commencement of the corporate insolvency resolution process (CIRP). Further, pursuant to the commencement of the CIRP, a moratorium is implemented on other dispute resolution proceedings against the corporate debtor, including arbitration proceedings. This article aims to discuss and analyse the interplay between arbitration and insolvency proceedings, and what remedy a creditor may choose in order to maximise its prospects of debt recovery.

Extent of moratorium and fate of arbitration during insolvency proceedings

A moratorium, once implemented under the IBC, prohibits 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[1]. Under the IBC, the treatment of arbitration proceedings that are pending and the ones that commenced after the beginning of insolvency proceedings is

[1] Section 14 of the IBC

the same, i.e. no procedure or recourse is available for overcoming the moratorium imposed under the IBC for initiation/ continuation of the arbitration. Therefore, the arbitration proceedings would be stayed until the resolution plan is formulated, thereby complicating the efforts for recovery of monies from the corporate debtor.

This position has been bolstered by the judgement passed by the Supreme Court of India in the case of *Alchemist Asset Reconstruction Company Ltd. v Hotel Gaudavan Pvt. Ltd*[2]., where the court held that:

> *"4. The mandate of the new Insolvency Code is that the moment an insolvency petition is admitted, the moratorium that comes into effect under s. 14(1)(a) expressly interdicts institution or continuation of pending suits or proceedings against Corporate Debtors.*
>
> *5. This being the case, we are surprised that an arbitration proceeding has been purported to be started after the imposition of the said moratorium and appeals under Section 37 of the Arbitration Act are being entertained. Therefore, we set aside the order of the District Judge dated 06.07.2017 and further state the effect of Section 14(1)(a) is that the arbitration that has been instituted after the aforesaid moratorium is non est in law."*

Having stated the above, courts have, however, in certain cases carved out exceptions to the said prohibitions and have allowed arbitration proceedings to continue when:

a. it leads to maximization of the assets of the corporate debtor;
b. the corporate debtor would be benefitted by the said proceedings and the same would not adversely affect the assets of the corporate debtor; and
c. if proceedings are allowed to be continued, no recovery can be pursued against the corporate debtor during the operation of moratorium period, etc.

The Delhi High Court, in the case of *Power Grid Corporation of India Ltd. v. Jyoti Structures Ltd*[3]., while analysing the scope of moratorium under the IBC, reiterated the abovementioned principles and held as follows:

> *"8. The object of the Code is to provide relief to the corporate debtor through "standstill" period during which its assets are protected from dissipation or diminishment, and as a corollary, during which it can strengthen its financial position….*
>
> *… Section 14 of the Code would not apply to the proceedings which are in the benefit of the corporate debtor, like the one before this court in as much these proceedings are not a 'debt*

[2] AIR 2017 SC 5124

[3] 246 (2018) DLT 485

recovery action' and its conclusion would not endanger, diminish, dissipate or impact the assets of the corporate debtor in any manner whatsoever and hence shall be in sync with the purpose of moratorium which includes keeping the corporate debtor's assets together during the insolvency resolution process and facilitating orderly completion of the process envisaged during the insolvency resolution process and ensuring the company may continue as a going concern" (emphasis supplied)

Further, the IBC stipulates an overriding effect of the IBC over any other statute and provides that: "*… the provisions of this Code shall have effect, notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law.*" (Section 238 of the IBC)

The courts, in the past, have allowed such proceedings to continue which in the court's view would not diminish, disperse, or adversely impact the assets of the corporate debtor in any manner whatsoever. The Supreme Court of India, in *Indus Biotech Private Limited vs. Kotak India Venture (Offshore) Fund & Ors*[4]., has observed that "*… the position of law that the IB Code shall override all other laws as provided under Section 238 of the IB Code needs no elaboration….If the irresistible conclusion by the Adjudicating Authority is that there is default and the debt is payable, the bogey of arbitration to delay the process would not arise despite the position that the agreement between the parties indisputably contains an arbitration clause.*"

The statutes relating to arbitration and insolvency are special statutes operating under different domains of law. However, section 238 of the IBC gives an overriding effect to the IBC over all other statutes. Therefore, if a creditor has a debt arising out of any contractual obligations, then the strategic evaluation of the available options before commencing a debt recovery action require an assessment of the pros and cons of arbitration and insolvency proceedings.

Treatment of arbitral award vis-à-vis CIRP

An arbitral award under the IBC constitutes debt, and an award holder is a creditor. Whether such an arbitral award constitutes financial or operational debt was discussed by the National Company Law Appellate Tribunal (NCLAT), in the case of *Sushil Ansal v. Ashok Tripathi and Ors*[5]. In the said case, NCLAT observed that:

> *"A 'decree-holder' is undoubtedly covered by the definition of 'Creditor' under Section 3(10) of the 'I&B Code' but would not fall within the class of creditors classified as 'Financial Creditor' unless the debt was disbursed against the consideration for time value of money or falls within any of the clauses thereof as the definition of*

[4] Civil Appeal No.1070 /2021 @ SLP (C) NO. 8120 OF 2020.

[5] Company Appeal (AT) (Insolvency) No. 452 of 2020

'financial debt' is inclusive in character. A 'decree' is defined under Section 2(2) of the Code of Civil Procedure, 1908 ("CPC" for short) as the formal expression of an adjudication which conclusively determines the rights of the parties with regard to the matters in controversy in a lis….

…. The answer to the question whether a decree-holder would fall within the definition of 'Financial Creditor' has to be an emphatic 'No' as the amount claimed under the decree is an adjudicated amount and not a debt disbursed against the consideration for the time value of money and does not fall within the ambit of any of the clauses enumerated under Section 5(8) of the 'I&B Code'."

Accordingly, the sum awarded in an arbitral award does not fall under the definition of a financial debt under section 5(8) of the IBC. Therefore, the same, under usual circumstances, would be considered as an operational debt under the IBC. However, it is often the case that operational creditors are unable to recover the full amount of their debt through a resolution plan and need to take a significant haircut depending upon the value of the assets owned by the corporate debtor. Further, as per the provisions of the IBC, operational creditors (in this case arbitral award holder) can initiate insolvency proceedings if such debts are undisputed. However, the Supreme Court of India, in the case of *K. Kishan v. Vijay Nirman Company Ltd.*[6], has held that awards against which proceedings are available for setting aside the award would not be considered as 'final', and the debt would be considered disputed until those proceedings are disposed of by the relevant court. The Supreme Court, in the said case, further explained that insolvency may be initiated based on an arbitral award when either the proceedings for setting aside have been rejected by the court concerned or the limitation period to file such proceedings has expired.

The Indian Arbitration and Conciliation Act, 1996, provides for three months as the limitation period for filing an application for setting aside an arbitral award. The award would be treated as final only pursuant to rejection of the setting aside proceedings of the arbitral award or expiry of the period of limitation. However, in case of a foreign arbitral award, the National Company Law Tribunal (NCLT), in *Agrocorp International Private (PTE) Limited v. National Steel and Agro Industries Limited*[7], has taken a contrary view and allowed the enforcement of a foreign award 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 to initiate insolvency proceedings in India. The said decision has been criticized, and the said ratio was not followed in subsequent cases by NCLT. In the subsequent case of *Aditya Energy Resource Pte Ltd. v. Simhapuri Energy Ltd*[8],

[6] Civil Appeal No. 21824 of 2017 decided on 14.08.2018

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

[8] NCLT Hyderabad, CP(IB) No. 389/9/HDB/2018, the said case is under appeal before the NCLAT.

NCLT rejected the application on the basis that the operational creditor (foreign award holder) had to obtain an order of enforceability as per the prescribed procedure.

Considering the above, the predicament a claimant faces is that despite the fact that it was able to secure an arbitral award, the enforcement of the same, considering ongoing insolvency proceedings, poses a challenge.

Conclusion

The overriding effect of the IBC over any other statute does have an impact on the strategy to be adopted for recovery of monies, as a party, despite being able to procure an award, would be left in a predicament that if the award so procured by it is incapable of being enforced if the insolvency proceeding is ongoing, or if enforced, does not yield a favourable outcome.
The embargo on arbitration proceedings upon imposition of the moratorium period stands with only few exceptions, as mentioned above. The award holders, as operational creditors, in most circumstances recover only a paltry amount of their dues. Therefore, the dichotomy between arbitration and insolvency proceedings shall continue as claimants would want to recover their monies from their corporate debtors. Although recent judicial precedents show that courts have acknowledged parallel arbitration proceedings, yet such proceedings are only allowed if they are for the benefit of the corporate debtor. Due to the recent economic stress, companies may be reluctant to pursue arbitration when it is expected that the insolvent party will be left with few assets, especially when the award holder would be a low-priority operational creditor under the IBC. However, the jurisprudence on this subject is still evolving. Therefore, one must be watchful of the developments in this area and parties would have to astutely evaluate their options of the appropriate mechanism for recovery of debts.

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