EFFECT OF COMMENCEMENT OF INSOLVENCY ON ARBITRAL PROCEEDINGS

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Insolvency law has the propensity to interfere with arbitration. This propensity emanates from the fundamental principle behind insolvency laws which includes inter alia, the equality of creditors and the centralization of claims. During the pendency of a Corporate Insolvency Resolution Process, there is a high degree of state control and mandatory and procedural law provisions which come into play and affect the assets of the party and the rights of the creditors and the trustee of the insolvent estate. The policy objective of 'asset value maximization' on which this law is based, focuses on keeping the corporate debtor as a 'going concern' and it is for achieving this purpose the insolvency law often interferes with other laws.

Arbitration law on the other hand is based on the principle of 'party autonomy' and 'privity of contract'. The validity of an arbitration agreement, capacity of the parties and arbitral proceedings are among aspects that get affected if one of the parties becomes insolvent. This effect of insolvency on arbitration is subjected to diverse treatment across jurisdictions. Typically, insolvency law provides exclusive jurisdiction of state courts and the mandatory stay or even preclusion of all other proceedings, which will certainly conflict with arbitration proceedings.

A perusal of the economic policy of states and the judicial interpretation shows that in certain situations the arbitral proceedings get suspended and the arbitration agreement becomes invalid. For instance until recently the Polish and Latvian law followed this practice. The new Law of Restructuring in Poland has rendered the earlier provision under the Polish Bankruptcy Code, which disallowed the continuation of arbitral proceeding, ineffective. In *MBNA America Bank v. Hill*, the US Court of Appeals held that it is only when the Arbitration Agreement "necessarily jeopardises" the objective of the Bankruptcy Code that the agreement can be held as invalid.[1]

However, in certain other situations, insolvency does not suspend the arbitral proceeding and/or render the arbitration agreement invalid. This is observed in the German, French and English jurisdictions.

The Indian Position

If after the commencement of an arbitration (where the governing law is Indian law), insolvency proceedings have been initiated against one of the parties in India, then the intersection of the Arbitration and Conciliation Act, 1996 and the Insolvency and the Bankruptcy Code, 2016 is to be examined to resolve the question of continuation of such an arbitral proceeding.

Section 14 of the Insolvency and Bankruptcy Code, 2016 imposes a moratorium and does not allow the initiation or continuation of legal proceedings against the corporate debtor.

> *Section 14: (1) Subject to provisions of sub-sections (2) and (3), on the insolvency commencement date, the Adjudicating Authority shall by order declare moratorium for prohibiting all of the following, namely:—*
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> *(a) the institution of suits or continuation of pending suits or proceedings against the corporate debtor including execution of any judgment, decree or order in any court of law, tribunal, arbitration panel or other authority...*

The subject of inquiry is whether arbitral proceedings come under the ambit of the definition of legal proceeding under this provision. If yes, then ideally it would mean that arbitral proceedings shall be discontinued by virtue of the moratorium and vice versa.

The National Company Law Appellate Tribunal ('NCLAT') in *Jharkhand Bijli Vitran Nigam Ltd. v. I.V.R.C.L. Limited & Anr.*[2], as also the judgment of a Single Judge of the High Court of Delhi in *Power Grid Corporation of India v. Jyoti Structures Ltd.*[3] gave parallel opinions in this regard. The courts opined that unless and until the proceeding has the effect of endangering, diminishing, dissipating or adversely impacting the assets of the corporate debtor, it is not to be prohibited under section 14(1)(a) of the code. Therefore, the assets of the debtor need to be preserved.

But in instances wherein such a proceeding shall place a burden on the assets of the corporate debtor, the object of the Code shall stand defeated and the courts have instructed to avoid following a blinkered approach and as a corollary arbitral proceeding should ideally come within the ambit of Section 14(1) (a). The interpretation of the law has been done in the favor of the corporate debtor. This is favorable and integral to the recovery of funds. It is to be noted that such a proceeding does not include an enforcement action; rather it possesses the qualities of an assessment.

The European Union and English Law

The Insolvency Regulation[4] is the governing law with respect to the status of pending lawsuits in the European Union in the event of insolvency. Article 15 of the Regulation states that: "the effects of insolvency proceedings on a lawsuit pending ... shall be governed solely by the law of the Member State in which that lawsuit is pending." The regulation allows the pending lawsuits regarding the assets of the debtor and affiliated rights to be subject to the laws of the jurisdiction under which such a lawsuit is pending (*lex fori processus*). If such a jurisdiction allows for continuation of the arbitral proceedings then they shall continue and vice versa. In resolving the Elektrim saga,[5] the Swiss Supreme Court held that such lawsuits include arbitral proceedings and shall be subject to the law of the state where such a proceeding is pending. Such a view is contrary to the view taken by the Indian courts which do not treat arbitral proceedings as legal proceedings. Also, the English law allows the continuation of the arbitral proceeding in the event insolvency proceedings are started against one of the parties to the dispute..

Conclusion

Legal proceedings under the Insolvency and Bankruptcy Code, 2016 should include arbitral proceedings under its ambit and a moratorium should consequently be applied to the same. If the drafters of the Code had intended to exclude arbitration proceedings when referring to "proceedings" they would have done so expressly. Arbitration must not be considered as the poor relation for the purpose of which saving provisions are to be drafted. The courts should also treat arbitral proceedings on the same pedestal. This would assist in fixing a few loopholes in relation to the application of the Arbitration and Conciliation Act, 1996. Parties to arbitration shy away from using Indian law as the applicable law for resolution of any anticipated

conflict due to the presence of such vagueness. The approach of the Indian courts which is based on the financial position of the debtor and his asset recovery shall make the resolution of a dispute with regard to jurisdiction of Indian laws even more complex if placed in a cross-border context because such an approach vests on convenience of application of law. When a provision explicitly allows for an inclusion or exclusion the same must be followed. The growing number of non-performing assets in the economy reflects a flawed judicial interpretation.

ENDNOTES:

[1] MBNA AMERICA BANK V. HILL, 436 F.3D 104 (2D CIR. 2006).

[2] Jharkhand Bijli Vitran Nigam Ltd. v. I.V.R.C.L. Limited (Corporate Debtor) & Anr., (2018), 285.

[3] Power Grid Corporation of India v. Jyoti Structures Ltd., (2018) 246 DLT 485.

[4] Insolvency Regulation, (EU) 2015/848.

[5] Syska & Anor v Vivendi Universal SA & Ors, [2009] EWCA Civ 677.