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NEXUS BETWEEN ARBITRATION AND INSOLVENCY CAUSING PROBLEMS: FINDING A SOLUTION FOR INDIA

- **Ahan Gadkari**
5th year student at Jindal Global Law School

Introduction

Most jurisdictions (and the UNCITRAL Model Law) do not guide how to proceed with an arbitration marred by the onset of a party's insolvency or whether insolvency proceedings can be avoided due to the existence of a valid and binding arbitration agreement. Thus, arbitration and insolvency can often be at odds with one another.[1] India is no exception to this dilemma; Due to a lack of statutory guidance and the absence of judicial precedents, there is uncertainty surrounding the initiation or continuation of arbitration proceedings, the effect of insolvency proceedings on a foreign-seated arbitration, the ability to participate in the insolvency resolution process, and the enforcement of an arbitral award concerning insolvency proceedings.[2]

After the passing of the Insolvency and Bankruptcy Code, 2016 ["**the Code**"] in India, the country's bankruptcy and insolvency framework was transformed. However, it is essential to note that apart from a moratorium, the drafters did not address how insolvency procedures would affect the arbitration process.[3] This circumstance, coupled with the fact that no clarifying provision exists in India's Arbitration and Conciliation Act, 1996 ["**the 1996 Act**"], has opened the door to pandora's box of uncertainty. Despite the absence of legislative guidance, the development of case law in India has shown both clear and murky jurisprudence in this field.[3] For example, an

[1] Deyan Draguiev, 'The Effect of Insolvency on Pending International Arbitration: What Is and What Should Not Be' (2015) 32 Journal of International Arbitration 511; James Rogers and Jonathan Sutcliffe, 'Effect of Party Insolvency on Arbitration Proceedings: Pause for Thought in Testing Times' (2010) 76 Arbitration: The International Journal of Arbitration, Mediation and Dispute Management 277; F Mantilla-Serrano, 'International Arbitration and Insolvency Proceedings' (1995) 11 Arbitration International 51.
[2] Alipak Bannerjee and Payel Chatterjee, 'The Arbitration and Insolvency Collision: The Indian Perspective' (*International Bar Association* 3 June 2021) <https://www.ibanet.org/arb-insol-india> accessed 20 December 2022. [3] Ibid.
[3] IBA, 'IBA Toolkit on Insolvency and Arbitration Questionnaire: National Report of India' (2021) <https://www.ibanet.org/MediaHandler?id=7875944E-D52D-48D1-92F5-BD33E84753E2> accessed 17 December 2022.

arbitration procedure is not maintainable if an insolvency action is allowed (i.e., the insolvency court is satisfied as to the presence of default in payment of a debt), as stated by the Supreme Court of India in *Indus Biotech Pvt Ltd v Kotak India Venture Fund.*[4] As the Court pointed out, however, an insolvency action involving rights in rem cannot supersede an arbitration procedure involving rights *in personam*.[5] The courts in several Asian jurisdictions, especially Singapore, have provided guidance on this matter. Given that the Code has only come into effect in the year 2016, India still has a way to go before it resolves the arbitration-insolvency conundrum.

What Does a Moratorium Mean and How Does it Interact with Arbitration

General

When the National Company Law Tribunal accepts an insolvency procedure, the Code imposes a moratorium.[6] Specifically, "*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 prohibited.[7] Further, it prevents any implantation action from taking place in India. However, the legislation does not distinguish between arbitration procedures already underway and those initiated after the establishment of insolvency proceedings, nor does it address ways to overcome the moratorium about the beginning or continuation of arbitration proceedings.

According to the Supreme Court's decision in *Alchemist Asset Reconstruction Co.*,[8] any arbitration or equivalent processes begun after the initiation of a "corporate insolvency resolution process" ["**CIRP**"] are null and void under the law, i.e., *non-est.*[9] However, despite the lack of statutory exceptions, certain exceptions have been created by judicial precedents and allow arbitration proceedings to continue if:[10]

i. the proceedings maximise the value of the corporate debtor's assets,

ii. the corporate debtor will benefit from the procedures, and its assets will not be harmed in any way,[11]

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[4] *Indus Biotech Pvt Ltd v Kotak India Venture Fund* 2021 SCC OnLine SC 268.
[5] *Vidya Drolia & Ors v DurgaTrading Corp* (2021) 2 SCC 1.
[6] Sara Jain, 'Analysing the Overriding Effect of the Insolvency and Bankruptcy Code, 2016' (2020) 13 NUJS Law Review 39.
[7] *KS Oils Ltd v State Trade Corporation of India Ltd & Anor* Company Appeal (AT) (Insolvency) No 284 of 2017.
[8] *Alchemist Asset Reconstruction Co Ltd v Hotel Gaudayan Pvt Ltd* AIR 2017 SC 5124.
[9] Rajeshwari Sengupta and Anjali Sharma, 'Corporate Insolvency Resolution in India: Lessons from a CrossCountry Comparison' (2016) 51 Economic and Political Weekly 37.
[10] Alipak Bannerjee and Payel Chatterjee, 'The Arbitration and Insolvency Collision: The Indian Perspective' (*International Bar Association* 3 June 2021) <https://www.ibanet.org/arb-insol-india> accessed 20 December 2022.
[11] *Power Grid Corporation of India Ltd v Jyoti Structures Ltd* 246 (2018) DLT 485.

iii. for the duration of the operational period, no collection actions may be taken against the corporate debtor. In addition, courts have historically been reluctant to delay claims and counterclaims against a corporate debtor where it was clear that the debtor would not be harmed until adjudication of the claims and counterclaims. In the event of CIRP victory, the stay of execution will be removed, and all remaining litigation will pick up where the decree left off.[12]

Recently, the courts had to decide whether security secured via intermediate measures in arbitration before the beginning of insolvency proceedings may be paid, notwithstanding the moratorium order.[13] Bombay High Court granted a motion stating that the arbitrator has complete authority for the distribution of assets and found that it would not be prevented by the moratorium in *Nahar Builders Ltd v Housing Development and Infrastructure Ltd*.[14] However, the Delhi High Court took a slightly different approach in *Morgan Securities and Credits Pvt Ltd v Videocon Industries Ltd*.,[15] deciding that the arbitrator only has partial authority, i.e., grant post-award interest only on the part of the sum due and not the full sum. Without a decision from the Supreme Court, the situation is still up in the air.

The Effect on Foreign-Seated Arbitrations

Does the Code's moratorium prevent foreign-seated arbitrations from commencing or continuing? India does not have a reciprocal agreement with any jurisdiction since the provisions of the Code pertaining to the recognition of cross-border insolvency have not been brought into effect.[16] In no case have Indian courts dealt with a challenge to enforcing a foreign award on public policy grounds since the arbitration proceeded in defiance of a moratorium order imposed by the NCLT. However, if the judgement debtor owns assets outside India, the foreign-seated award may be executed abroad. In this scenario, the award need not have any link with the laws of India.
Therefore, there may be no genuine prejudice. If an arbitration panel does not follow a stay of proceedings order, the parties may go to the courts in the arbitration's seat and ask for recognition of the order. If such an order were recognised, it would be binding on the tribunal.

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[12] *Jharkhand Bijli Vitran Nigam Ltd v IVRCL Ltd (Corporate Debtor) & Anor*, Company Appeal (AT) (Insolvency) No 285 of 2018.
[13] *SSMP Industries Ltd v Perkan Food Processors Pvt Ltd* CS (COMM) 470/2016 & CC(COMM) 73/2017.
[14] *Nahar Builders Ltd v Housing Development and Infrastructure Ltd.* 2020 SCC OnLine Bom 1044.
[15] *Morgan Securities & Credits (P) Ltd. v Videocon Industries Ltd.* 2021 SCC OnLine SC 3362.
[16] Edna Sussman and Jennifer Gorskie, 'Capturing the Benefits of Arbitration for Cross Border Insolvency Disputes' in Arthur Rovine (ed), *Contemporary Issues in International Arbitration and Mediation: The Fordham Papers* (Brill 2012); Velislava Hristova and Andrés Eduardo Alvarado Garzón, 'International Arbitration and Cross-Border Insolvency—Friends or Foes? Revisiting the Role of Arbitration in Resolving Cross-Border Insolvency-Related Disputes' (2021) 12 Journal of International Dispute Settlement 693.

In fact, most foreign-seated tribunals are hesitant to comply with Indian moratorium decisions and to postpone arbitration processes owing to a lack of reciprocal insolvency agreements with other jurisdictions.[17]

Arbitration and Insolvency are Being Handled Simultaneously

The Code does not automatically apply to any claim brought under an arbitration agreement. However, a creditor may submit a claim with the Interim Resolution Professional, provided the claim independently meets the criteria for a "financial" or "operational" debt ["**IRP**"]. If the IRP decides not to include a claim, the creditor may challenge that decision before the NCLT. The NCLT has the authority to accept or deny the claim, with additional appeals potentially reaching the Supreme Court.

If the claim is included in the CIRP, it will be considered a pending dispute, and the new investor (the Resolution Applicant) may handle it in any way it sees fit. In most situations, such claims would be allocated zero value, and the Resolution Plan would include a provision stating that all litigation/dispute resolution claims would be extinguished upon completion of the CIRP.[18] A successful Resolution Applicant must assume the corporate debtor free and clear of all prior obligations, as confirmed by the Supreme Court in *Essar Steel.*[19] The Supreme Court in *Ghanshyam Mishra and Sons Pte Ltd v Edelweiss Asset Reconstruction Co Ltd*[20] and a bench of the Calcutta High Court in *Sirpur Paper Mills Ltd v IK Merchants Pvt Ltd*[21] have both upheld this view.

Is an Arbitration Award Admissible as Evidence of a Debt under the Code?

Legal action for insolvency may be initiated based on an arbitral award. The Supreme Court confirmed in *K Kishan v M/s Vijay Nirman Co.*[22] that arbitral awards are acceptable records of an ongoing obligation, provided that the debt was not in dispute. However, the Supreme Court refused to accept the CIRP because a challenge had already been brought against the award and

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[17] Morshed Mannan, 'Are Bangladesh, India and Pakistan Ready to Adopt the UNCITRAL Model Law on CrossBorder Insolvency?' (2016) 25 International Insolvency Review 195.
[18] Rajeshwari Sengupta and Anjali Sharma, 'Corporate Insolvency Resolution in India: Lessons from a CrossCountry Comparison' (2016) 51 Economic and Political Weekly 37.
[19] *Committee of Creditors of Essar Steel India Ltd v Satish Kumar Gupta & Ors* 2019 SCC OnLine SC 1478.
[20] *Ghanshyam Mishra and Sons Pte Ltd v Edelweiss Asset Reconstruction Co Ltd* 2021 SCC OnLine SC 313.
[21] *Sirpur Paper Mills Ltd v IK Merchants Pvt Ltd* AP 550 of 2008.
[22] *K Kishan v M/s Vijay Nirman Company Pvt. Ltd & M/s Ksheerabad Constructions Pvt Ltd*, Civil Appeal No 21825 of 2017.

the arbitral tribunal's rejection of a counterclaim beyond the quantity of claim granted being a subject for review before the courts.[23]

An award creditor may take additional effective actions toward the execution of the award if it has been determined that the award is enforceable.[24] The NCLT disagreed in *Agrocorp International Pte Ltd v National Steel and Agro Industries Ltd*,[25] where it was determined that enforcement of a foreign award was not necessary to preserve a claim against a corporate debtor during its bankruptcy. A foreign creditor may initiate insolvency proceedings in India upon the award's finality in the arbitration seat.

The Prima Facie Standard: Taking a Lesson from Singapore

Jurisprudence

Considering this background, this article will examine the *prima facie* standard used by Singaporean courts. In *VTB*,[26] the parties entered into a share-repurchase agreement that stipulated binding arbitration for any issues that could arise. The respondent owed the appellant money because of the arrangement. However, the respondent terminated the agreement, claiming it owed USD 170 million when the value of the loan collateral dropped because of US Treasury regulations after the appellant did not make the required payment, the respondent-initiated winding-up processes.

As the underlying debt was contested on several fronts, the appellant fought against the motion in the first instance. However, when considering a winding-up application when the underlying debt is subject to arbitration, the standard of review is to be used as the primary issue before the Court. Here, the Singapore High Court ["**SGHC**"] was restricted by the Singapore Court of Appeal's ["**SCA**"] ruling in *Metalform* and decided to use the *triable issues* standard.[28] Ultimately, the Court ruled that the appellant's allegations were not presented in good faith and should be rejected.

The VTB case saw an appeal reject the SGHC's decision. A study across jurisdictions led to the SGCA's conclusion that the prima facie level of review is the appropriate standard to implement. In particular, if the Court is convinced that there is a disagreement between the applicant creditor and the putative debtor subject to an arbitration agreement, it would often reject the winding-up motion, assuming the issue is not brought up in an abuse of the Court's process.

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[23] Ibid.
[24] *Fuerst Day Lawson Ltd v Jindal Exports* (2001) 6 SCC 356; *Government of India v Vedanta Ltd & Ors*, SLP (Civil) No 7172 of 2020.
[25] *Agrocorp International Pte Ltd v National Steel and Agro Industries Ltd* CP (IB) No 798/ MB/ C-IV/2019.
[26] *AnAn Group (Singapore) Pte. Ltd. v VTB Bank (Public Joint Stock Co.)* [2020] 1 S.L.R. 1158. [28] *Metalform Asia Pte. Ltd. v Holland Leedon Pte. Ltd.* [2007] 2 S.L.R.(R.) 268 [59].

However, the Court may grant a postponement (rather than dismissal) of the winding-up proceedings if the applicant creditor can prove legitimate doubts about the company's viability as a going concern and no triable arguments are given by the debtor. Suppose the creditor can prove, for instance, that the debtor-company has no genuine desire to arbitrate the issue and is actively seeking to suppress the arbitration. In that case, the Court may allow the winding-up to proceed. The SGCA found that the facts supported the appellant's position at the prima facie level of scrutiny.

The SGCA bench considered both the *BWG v BWF* (BWG) and *VTB* appeals since they raised the same legal question about the appropriate application threshold. Similarly, BWG's creditors fought a winding-up petition on the grounds that the debt itself was in the dispute or that the debtor was trying to game the system by asking for a stay of proceedings. The SGCA based its rejection of the appeal in *BWG* on the findings of law in *VTB*, holding that the prima facie criterion had been met.

Analysis

Since the Court alone has the power to issue winding-up orders, it is well-established that liquidating an insolvent business is not subject to arbitration.[27] However, this does not mean that all underlying issues may not be arbitrated. For example, the SGCA noted in *Tomolugen* that not all disputes are ineligible for arbitration simply because the remedy sought may only be obtained via the Court.[28]

To decide whether any of the claims made throughout the dispute constitute a "matter" subject to and capable of resolution by arbitration under section 6 SIAA, the Court must undertake a "practical and common-sense inquiry." The Court is tasked with digging into the specifics. In most cases, a "matter" under the meaning and scope of section 6 of the Singapore International Arbitration Act (SIAA) [31] will be any reasonably severe problem that is not just ancillary. Instead of painting a broad picture of the conflict, this method better reflects the reality that most legal conflicts include several interrelated concerns.

It is exemplified well by *Tomolugen's* factual matrix.[29] After experiencing oppression as a minority shareholder, the respondents sought judicial relief under Section 216 of the Singapore Companies Act (CA).[33] The appellant sought a stay under Section 6 SIAA on the grounds that the parties'

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[27] Alan Gropper, 'The Arbitration of Cross-Border Insolvencies' (2012) 86 American Bankruptcy Law Journal 201.
[28] *Tomolugen Holdings Ltd. v Silica Investors* [2016] 1 S.L.R. 373 [2]. [31]
Singapore International Arbitration Act, 1994, s. 6.
[29] *Tomolugen Holdings Ltd. v Silica Investors* [2016] 1 S.L.R. 373 [2]. [33]
Singapore Companies Act, 1967, s. 216.

share sale agreement included an arbitration clause that applied to a portion of the dispute. While the SGCA acknowledged that the Court might be the sole entity empowered to provide some remedies available under section 216 CA (such as a winding-up order), it emphasised that this did not automatically render section 6 SIAA ineffective. Instead, the Court identified four separate "matters" at issue and noted that one of them seemed to be within the purview of the arbitration agreement. Since then, a stay was imposed on this lawsuit under Section 6 SIAA. And in the name of justice, the Court was ready to use its case management authority to stop the whole process until the arbitration was finalised.

The debt dispute with VTB was also a significant problem that was settled via arbitration. The petitioner's locus standi is in question if there is any dispute about the veracity of the debt or the validity of the winding-up petition filed by the putative creditor. Using the granular approach in *Tomolugen*, it seems that section 6 SIAA applies to the dispute over the underlying debt in *VTB*.

Further, it has been claimed that insolvency policy issues are not engaged *stricto sensu* in a windingup petition if the underlying debt is contested since the alleged debtor organisation has not been proven to owe a payment. If this is true, a debtor-creditor disagreement has not yet triggered the insolvency system. Therefore, any apparent conflict between the insolvency system and the arbitration regime has been observed in cases like VTB and Salford Estates.

The goal of the abuse of process exemption in VTB may be able to be included within the confines of section 6 SIAA without the need for government intervention. As stated in Section 6(2) of the SIAA, the Singapore court has the right to issue a stay "*upon such terms or conditions it may think fit*." In practise, the courts may grant a stay on the condition that the debtor-company actively participates in any arbitration initiated by the creditor or impose other terms or conditions to mitigate any complaints a creditor may have that the debtor-company is abusing the Court's processes, depending on the specifics of the case.

Conclusion

In light of the challenges many arbitral tribunals and parties encounter, the International Bar Association has released a Toolkit on International Arbitration and Insolvency,[30] an explanatory memorandum analysing the effects of insolvency on domestic and international arbitration, checklist on insolvency and arbitration for use by arbitrators, lawyers, and parties, and national reports from 19 jurisdictions discussing the relationship between insolvency and arbitration. It is

[30] IBA, 'IBA Toolkit on Insolvency and Arbitration Questionnaire: National Report of India' (2021) <https://www.ibanet.org/MediaHandler?id=7875944E-D52D-48D1-92F5-BD33E84753E2> accessed 17 December 2022.

crucial in India to find a middle ground between (1) allowing a company's new management (incoming investors) to start over with a clean slate after the completion of the CIRP and (2) allowing parties to litigation or arbitration proceedings to be permanently barred from pursuing their claims after a moratorium order and subsequent approval of the Resolution Plan. With the corporate debtor having been saved, the parties to the arbitral proceedings will effectively get no award and would have no recourse. It is predicted that insolvency actions against corporate debtors will expand in India in the future, affecting investor confidence in the enforcement of contracts and the country's marred ease of doing business.[31] For this reason, a new strategy, such as the *prima facie* standard, is required, which can provide investors consistency. In addition, it might be time to adopt a model from other jurisdictions and use arbitration and insolvency together to resolve overlapping claims.

[31] Anjali Singh, 'Ease of Doing Business in India: A Vision of Make in India' (2018) 63 Economic Affairs 1.