THE CONUNDRUM OF ARBITRABILITY IN INSOLVENCY AND BANKRUPTCY CASES

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Introduction

The Insolvency and Bankruptcy Code ["**IBC**"] was enacted by the Central Government to facilitate a smooth and efficient liquidation and rehabilitation process. The code has brought a drastic change in improving the legislation related to liquidation and rehabilitation of sick industries. There were many key changes introduced in this code which brought an improvement in the then-existing rules and procedures related to insolvency proceedings. To give effect to the same, National Company Law Tribunal ["**NCLT**"] is given the power of sole *Adjudicating Authority* for matters related to IBC.[1] In case of default, the creditors can approach the NCLT to initiate the Corporate Insolvency Resolution Process ["**CIRP"**] against the Corporate Debtor. While NCLT acts as a public forum to decide the matters, private forums like Alternative Dispute Resolution mechanisms, particularly arbitration, are used by parties more often.

The conundrum arises when there exists an arbitration clause in the agreements between the Financial/Operational Creditor and Corporate Debtor. In common parlance, there are some matters which cannot be decided by a private forum, and the exclusive authority lies with the courts and tribunals. As per the judgement given in *Booz-Allen & Hamilton Inc vs. SBI Home Finance Ltd. and Ors*[2] case, insolvency and bankruptcy were considered to be such matters in which an arbitral tribunal does not have the power to give awards. Hence, there has been a lot of debate surrounding the arbitrability of IBC cases. This is in the premise of the recent Supreme Court judgements that upheld the arbitrability of IBC cases. This article will address the conundrum of arbitrability in insolvency and bankruptcy cases by firstly identifying the relevant provisions under both statutes that are overlapping or in conflict with each other. The author will also analyse the interpretation done by courts in resolving this conflict. By the end of this article, the author will provide suggestions with respect to the changes that can be brought in the current legislative framework to overcome the shortcomings that created confusion and conflict.

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[1] Insolvency and Bankruptcy Code 2016, s 5(1).

[2] *Booz-Allen & Hamilton Inc v SBI Home Finance Ltd and Ors* (2011) 5 SCC 532.

One of the major goals of IBC is to expedite the process to effectively dispose of the matters in a time-bound manner. To give effect to the same, financial/operational creditors can file a CIRP application before NCLT.[3] The tribunal will decide whether to admit the matter or reject the application within 14 days.[4] Once the CIRP application is admitted, the insolvency resolution process begins.

Under the provisions of the Arbitration and Conciliation Act, when there exists an arbitration agreement or a clause pertaining to the same in the contract between two pirates, then the court must refer such matter to the arbitral tribunal.[5] The tribunal can, at any time during the proceeding, make an interim arbitral award.[6] Once the proceedings are completed, the tribunal gives the award.[7]

Currently, there is no clarity under both the statutes as to how and at what stage arbitration can be resorted to by the parties while CIRP is pending before NCLT. However, some of the recent judgements of NCLT and Hon'ble Supreme Court and High Courts have played a major role in establishing the scope and arbitrability of insolvency proceedings.

Overlapping of provisions

The conundrum arises owing to the overlapping of IBC, 2016 and Arbitration and Conciliation Act, 1996 as well as contrasting judgements of the judiciary with respect to the arbitration proceeding during the pendency of CIRP before NCLT. As per the code, after the admission of CIRP application, the adjudicating authority shall declare a moratorium prohibiting initiation or continuation of any proceeding in any court or tribunal, including arbitration.[8] However, in the case of *Power Grid Corporation of India Ltd v Jyoti Structures Ltd*[9], this prohibition has been relaxed on the grounds that such arbitration proceedings are beneficial for corporate debtors and will not affect the value of assets of corporate debtors. It is still unclear as to what is the role of arbitration while a CIRP is ongoing against the corporate debtor and what kind of arbitral award can be given by the arbitral panel considering the sole power to adjudicate lies with the NCLT.

In a few judicial precedents, it was held that insolvency matters are *right in rem* since, after admission of CIRP, the right to realise debt is opened to all the creditors to whom the corporate debtor owes

[3] Insolvency and Bankruptcy Code 2016, s 7(1).
[4] Insolvency and Bankruptcy Code 2016, s 7(4).
[5] Arbitration and Conciliation Act 1996, s 8.
[6] Arbitration and Conciliation Act 1996, 31(6).
[7] Arbitration and Conciliation Act 1996, s 31.
[8] Insolvency and Bankruptcy Code 2016, s 14(1)(a).
[9] *Power Grid Corporation of India Ltd v Jyoti Structures Ltd* 246 (2018) DLT 485.

a debt.[10] However, allowing arbitration while CIRP is in progress contradicts the courts' position on non-arbitrability of insolvency proceedings.

Another confusion persists with respect to the overriding effect of IBC under section 238. As per the section, the provisions of IBC will override any statute dealing with the subject matter that IBC deals with.[11] IBC is a special statute for insolvency and liquidation matters, while Arbitration and Conciliation Act is a general statute dealing with arbitration and conciliation proceedings. It is a well-settled provision upheld by various judgements of the Supreme Court that a special statute will have an overriding effect on general statute.[12] This section implies that the IBC seeks to limit the adjudicating authority to the exclusive jurisdiction of the IBC, thus alienating provisions of other statutes. As rightly iterated in the *Re United State Lines Inc.,*[13] Insolvency and arbitration laws are nearly opposites in their approach: arbitration law favours a decentralised approach to dispute settlement, while bankruptcy laws follow a centralised mechanism. However, if the recent trends in the judgments are to be observed, arbitration is allowed at a certain stage of the insolvency process. This prima facie contradicts the overriding effect of IBC. While interpreting the conflict between two statutes, courts have used harmonious construction. The Hon'ble Supreme Court in the case of *K. Kishan v. Vijay Nirman Co (P) Ltd*[14] held that section 238 of IBC will only override in case there is an inconsistency between the application of some provision of two statutes.

Judicial Analysis

One of the first landmark judgments that interpreted the concept of arbitrability was the *Booz-Allen* case.[15] The three aspects that were prescribed to be taken into consideration while deciding whether a matter is arbitrable are; Whether the subject matter of the dispute is eligible for arbitration? ii) Whether the subject matter of the dispute is covered by an arbitration clause in an agreement? iii) Whether parties intend to resolve disputes by arbitration?
It was held in the judgement that insolvency and bankruptcy matters cannot be arbitrated as these matters are *right in rem*[16] whereas matters that can be arbitrated are *right in personam.*

10 *Vidya Drolia v Durga Trading Corp* (2021) 2 SCC 1.
11 Insolvency and Bankruptcy Code 2016, s 238.
12 *Urja Vikas Nigam v Essar Power Ltd* (2008) 4 SCC 755. *Suresh Nanda vs C.B.I* (2008) SCC 3 674
13 *United States Lines, Inc v American Steamship Owners Mutual Protection and Indemnity Association, Inc* 197 F.3d 631 (2nd Cir. 1999).
14 *K. Kishan v Vijay Nirman Co (P) Ltd* (2018) 17 SCC 662.
15 *Booz-Allen & Hamilton Inc v SBI Home Finance Ltd and Ors* (2011) 5 SCC 532.
16 *Swiss Ribbons Pvt. Ltd v Union of India,* (2019) 4 SCC 17.

However, this stand is departed in the recent landmark judgement of *Indus Biotech Pvt Ltd v Kotak India Venture Ltd and Ors.*[17]

One of the main issues before the Hon'ble Supreme Court was whether the petitioner company's claim to invoke the arbitration clause was justified, given that the financial creditor had filed a CIRP application before NCLT, and whether the dismissal of that application and referral to the arbitral tribunal was valid. The court applied the rule of harmonious construction to assess this issue. Section 7 of the IBC, 2016, and Section 8 of the Arbitration and Conciliation Act, 1996 were in conflict in this case. The Hon'ble Supreme Court remarked that when two provisions of law, one is a general law while the other being a special law, regulate a matter, the court should attempt to apply a harmonious construction to the aforementioned provisions. However, when the statute is clear as to which law should prevail, the same should be given effect. The court brought harmony between the two provisions by demarcating the criteria for invoking rights provided under these two provisions. The court held that in case if there is an arbitration clause in the agreement between the two parties, it is the duty of the adjudicating authority in IBC cases to refer such matter to an Arbitral Tribunal. The court established that arbitration can be resorted to only before admission of CIRP application by NCLT. Placing reliance given in the *Vidya Drolia* case, the court held that the insolvency proceeding becomes *right in rem* only after the application is admitted by the NCLT. Hence, before admission, parties can resort to arbitration, and NCLT can refer matters to an arbitral tribunal where an arbitration clause exists in an agreement.[18] The court also relied upon the judgement given in *Innoventive Industries Ltd v ICICI Bank and Anr.*[19] and held that mere existence of debt cannot trigger an application under section 7 and the adjudicating authority should accept the application only when it is satisfied that the debt is owed and defaulted by the corporate debtor. While the judgement exhaustively covered the scope of arbitration in an insolvency proceeding and clarified the *right in personam* and *right in rem* stages of CIRP, it has still left a lot of scope for interpretation and misuse. Corporate debtors can misuse the arbitration proceedings only to delay the insolvency resolution process. Moreover, there is no clarity as to what kind of matters can or cannot be arbitrated. When a CIRP application is filed by a financial creditor, it implies that there exists a debt that has been defaulted by the corporate debtor. When such a matter is referred to an arbitral tribunal merely because the arbitration clause exists in the agreement, it will only lead to a delay in the ultimate CIRP.

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17 *Indus Biotech (P) Ltd v Kotak India Venture (Offshore) Fund* (2021) 6 SCC 436.

18 *Vidya Drolia v Durga Trading Corp* (2021) 2 SCC 1.

19 *Innovative Industries Ltd v ICICI Bank and Anr* (2018) 1 SCC 407.

This judgement has also not clarified as to what is the role of an arbitral tribunal in insolvency matters and what kind of awards can be conferred by the arbitral tribunal. Arbitral Tribunal cannot order initiation of insolvency proceedings nor it can give an award that only NCLT has authority to decide. In an instance where the ultimate result is the initiation of CIRP, the arbitral tribunal does not hold power to initiate the CIRP. In such circumstances, it becomes vague as to how beneficial will be the interference of an arbitral tribunal in an insolvency proceeding.

Conclusion

From the conflicting provision under the IBC and Arbitration and Conciliation Act and the contrasting stand of the judiciary with respect to the arbitrability of insolvency proceedings, it is evident that there is a lot of confusion with respect to the scope and application of arbitration while a CIRP is pending before the NCLT. With the increasing trend of parties inculcating arbitration clauses or agreements in debt matters, there is a need to amend IBC and include provisions specifically related to the existence of arbitration clauses and situations in which parties to such proceedings can seek arbitration. The recent judgements have played a pivotal role in establishing the scope and power of both the statutes with respect to the conflicting subject matter. Hence, IBC should be amended and include provisions related to (i) establishing the overriding effect of IBC, if required, and clarifying the situations in which such effect can be relaxed and interpreted by the court on the basis of facts and circumstances of the case, (ii) stricter provisions to prevent intentional delay and misuse of the arbitration clause by the corporate debtor, (iii) clarifying the type of arbitral awards that can be conferred by the arbitral tribunal, (iv) clarifying the stages of CIRP during which an arbitration proceeding can or cannot be sought by the parties.