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# RESOLVING THE CONUNDRUM BETWEEN ARBITRATION AND INSOLVENCY LAWS IN INDIA

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## Introduction

The intersection of arbitration and insolvency has assumed greater significance with the evolution of a new insolvency regime in India. Often referred to as a 'conflict of near-polar extremes'[1] and driven by divergent goals with respect to their policies, insolvency exerts an inexorable pull towards a centralised policy, whereas, arbitration advocates a decentralised approach toward dispute resolution.[2]

Moreover, a theoretical conflict between arbitration and insolvency becomes apparent due to the opposing interests of the Corporate Debtor ["**CD**"] and creditor where the CD is inclined towards challenging the impending insolvency application against them and, subsequently, resolving it through arbitration. This choice is premised on two arguments, namely, the existence of a 'default' in payment and a cross-claim against the creditor. The stay on insolvency proceedings allows the CD to retain control over their company's assets and steer the arbitration proceedings by appointing arbitrators, forums, and tribunals of their choice. On the contrary, the Insolvency and Bankruptcy Code, 2016 ["**The Code**"] strives to safeguard the creditor's stake by maximising the CD's assets.

This paper sheds light on the current conundrum of the arbitrability of insolvency disputes in India. The first part of the paper focuses on legal provisions pertaining to the *arbitrability of insolvency matters and lays down the trajectory of the legal pronouncements on the subject. The second part outlines American jurisprudence and draws a comparison between the two legal frameworks. Finally, the paper concludes by suggesting a* prudent and calculative approach that consolidates the benefits of both systems.

[1] Lexa Hilliard, 'International Arbitration and Insolvency: A Conflict of Near Polar Extremes' (2009) 14 Int Corp Rescue 83.
[2] *In Re United States Lines Inc.* 197 F 3d 631 (2d Cir. 1999).

**The Interplay of Arbitration and Insolvency in the Indian Context**

The issue of arbitrability and insolvency disputes is the conflict of a "choice of forum" wherein parties have chosen to submit themselves to the jurisdiction of the arbitrators and an insolvency regime that forces them to submit to the jurisdiction of the specialized insolvency courts. Several arbitration matters and ensuing court enforcements have confronted parallel insolvency proceedings that grapple with complicated legal issues.

The absence of a standard dispute resolution court to decide such disputes with global recognition impedes legal proceedings worldwide.[3] Since both the Arbitration Act and the Code remain silent on the issue, it has made way to uncharted territory and raised pertinent questions about applying insolvency and arbitration proceedings in each other's vicinity. Insolvency judges and practitioners have also dealt with complex cases of failing enterprises with assets spread worldwide.

This Section sheds light on the relevant provisions under the Indian insolvency regime and the Arbitration Act that outline the current jurisprudence on their intersection in the Indian sub-continent.

*Arbitrability of Subject-matter*

In an attempt to settle the position of law on the issue of the arbitrability of insolvency disputes in India, the Apex Court clarified that the Code shall prevail over all statutory enactments, including the Arbitration and Conciliation Act, 1996 ["**Arbitration Act**"].[4] In other words, an application seeking reference to arbitration under Section 8 of the Arbitration Act is not maintainable if it is filed after the admission of an insolvency proceeding under Section 7 of the Code. In another recent judgement, it pronounced that insolvency and arbitration proceedings could not be conducted simultaneously.[5]

While it sought to crystallise the guidelines determining the arbitrability of insolvency proceedings, the court was cautious of the fact that arbitration could be used as a moonshine defence by the CD to delay the insolvency proceedings. To avoid such occurring, it laid down that arbitration proceedings shall depend on the existence of a 'default' within the meaning of the Code and be

[3] Simon Vorburger, '*International Arbitration, and Cross-Border Insolvency: Comparative Perspectives' (Kluwer Law International*, 2014).
[4] *Indus Biotech (P) Ltd. v Kotak India Venture (Offshore) Fund* [2021] SCC OnLine SC 268.

[5] *M/s. KK Ropeways Ltd. v M/s. Billion Smiles Hospitality Pvt. Ltd.* [2021] **Comp. App (AT) (CH) (INS.) No. 246 of 2021.**

maintainable only after the latter is dealt with and consequently rejected by the adjudicating authority.

Furthermore, the National Company Law Appellate Tribunal ["**NCLAT**"] opined that there is no embargo on the Operational Creditor to invoke Section 9 of the Code for recovery of payment instead of relying on the arbitration clause in the agreement.[6] The ruling aligns with the scope and objective of the Code, which describes the insolvency tribunal as a 'Resolution' and not a 'Recovery' forum. However, unwilling parties may use it to commence judicial or insolvency proceedings, thereby derailing arbitral proceedings.

Additionally, the Supreme Court noted that insolvency and winding-up matters are not arbitrable under the current Indian jurisprudence.[7] Since insolvency disputes are concerned with the rights of third-party creditors and their interest in the resolution process, such disputes were categorised as non-arbitrable by the court.[8] A three-judge bench of the Apex Court envisaged a four-pronged test to determine the arbitrability of disputes. According to the test, the disputes in which the subject matter or cause of action is arising from an action *in rem* is non-arbitrable,[9] rendering insolvency disputes inarbitrable in nature.

Yet, conflicting with the settled practice, the Supreme court has recently allowed the aggrieved creditor to pursue their unpaid dues before an arbitral tribunal, after their claim was rejected under CIRP.[10] Similarly, it took a progressive stance in PASL Wind Solutions case[11], and held that domestic parties have the right to choose a foreign seat of arbitration to pursue insolvency proceedings against foreign entities. Such arbitral awards shall be recognised as "foreign awards" under Section 48 of the Arbitration Act. Thus, while the Code has firmly established itself as a landmark legislation yielding successful results in a short span of time, India must adopt a prudent and calculative approach to further the ends of the Insolvency Code. Hence, considering its rapidly developing and globally outward-looking economy, the adoption of arbitration as a means to resolve insolvency disputes in India would attract foreign investment and foster investor confidence in the business system.

*In Rem v. In Personam Rights*

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[6] *Shahi Md. Karim v Kabamy India LLP* [2023] SCC OnLine NCLAT 180.

[7] *A. Ayyasamy v A. Paramasivam* [2016] 10 SCC 386.

[8] *Booz Allen and Hamilton Inc. v SBI Home Finance Ltd.* [2011] 5 SCC 532.

[9] *Vidya Drolia v Durga Trading Corpn* [2021] 2 SCC 1.

[10] *Fourth Dimension Solution Limited v. Ricoh india Limited and Ors.* [2022] Civil Appeal 5908/2021.

[11] *PASL Wind Solutions Private Limited v. GE Power Conversion India Private Limited* [2021] AIR 2021 SC 2517.

Although the *Vidya Drolia* case confirmed that insolvency disputes fall within the ambit of actions *in rem*, it clarified that a mere application under Section 7 of the Code would not automatically render the action *in rem* non-arbitrable. Therefore, whether to proceed with insolvency proceedings or refer the disputes to arbitration still remains unanswered. This has led to several courts carving out exceptions to this position, thereby jeopardising the existing stance of the Apex authority. Presently, arbitration proceedings that maximise the value of the CD's assets or do not injure their company's assets have been allowed.[12]

Section 7 would be applicable only if the following factors are satisfied- (i) a debt exists; (ii) default should have occurred; (iii) debt should be due to the financial creditor; (iv) such default which has occurred should be by a corporate debtor.[13] Upholding the same, the Calcutta High Court[14] and the National Company Law Tribunal[15] ["**NCLT**"] have observed that arbitration proceedings must take precedence over insolvency disputes. In other words, the insolvency application becomes infructuous if a pre-existing dispute is pending under Section 34 of the Arbitration Act against the award and the final adjudicatory process is yet to occur.[16]

By pronouncing that insolvency proceedings become *in rem* only upon admission, the adjudicatory body has prevented the "dressing up" of relief such that a financial creditor could not escape the mandatory arbitration clause in their agreement by merely filing an application for insolvency proceedings. Drawing precedence from this rationale, the High Courts have restricted themselves to adjudging the existence of a valid dispute under the Arbitration Act. They have taken the view that arbitration and insolvency can continue simultaneously till the application under the Code has not been admitted[17] or the moratorium under Section 14 has not been imposed.[18] However, it has failed to highlight the circumstances where the tribunal may admit the arbitration application, paving the way for a uniform legislative guide in issues pertaining to the arbitrability of insolvency claims. The suggested legislative guide would not only clarify what is arbitrable and what is not, but also law the foundation of a fair, and predictable dispute resolution adjudicatory system that conforms to international standards, and encourages foreign businesses.

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[12] *Power Grid Corpn.of India Ltd. v Jyoti Structures Ltd.* [2018] 246 DLT 485.
[13] *Innovative Industries Limited v ICICI Bank and Another* [2018] 1 SCC 407.
[14] *Sirpur Paper Mills Ltd. v I.K. Merchants Pvt. Ltd.* [2020] SCC OnLine Cal 2939.

[15] *Anuratan Textiles Private Limited v Amalra International Private Limited* [2021] SCC OnLine NCLT 12028.
[16] *K. Kishan v Vijay Nirman Co.* [2018] 8 MLJ 177.

[17] J*asani Realty (P) Ltd. v Vijay Corpn.* [2022] SCC OnLine Bom 879.

[18] *Millennium Education Foundation v Educomp Infrastructure and School Management Limited* [2022] SCC OnLine Del 1442.

*Impact of the Moratorium*

A bare reading of 14 of the Code envisages the declaration of the moratorium period that puts a stay on all arbitration proceedings against the debtor[19] to provide a 'calming period' to the debtor. It serves a two-fold purpose- to maximise the value of the assets owned by the debtor and to retain the value of all assets owned by the debtor by putting a stay on all legal actions against them. The broadly-worded Section 14(1)(a) of the Code invites problems as the ban on an arbitrator to render awards under the statutory insolvency framework has been equated to the non-arbitrability of insolvency matters.[20]

A CD who has defaulted on their payments may seek initiation of the Corporate Insolvency Resolution Process ["**CIRP**"] by submitting an insolvency application before the concerned authority. The arbitration proceedings initiated after the commencement of CIRP are considered *non-est in law,*[21] *and the arbitral award rendered against the CD will constitute a 'default', as defined in the Code.*[22] *Such* proceedings which are pending on the date of commencement of CIRP could not proceed during the moratorium[23] and shall not be perceived as a hindrance to the initiation of CIRP under the Code.[24] It can be reinstated only after the CIRP has been finalized. While the scheme prevents a multiplicity of proceedings against a financially distressed company and provides for a centralised framework,[25] the Delhi High Court adopted a purposive approach and held that Section 14 would not apply to proceedings for value maximisation of the assets of the CD.[26] Therefore, the continuation of arbitration proceedings after the declaration of the moratorium would be determined based on whether the claims are for the CD or in the nature of debt recovery action against the CD.

**The USA Insolvency Framework- A Preview**

Jurisdictions like the United States of America ["**USA**"] and the United Kingdom ["**UK**"] have attempted to harmonise the international insolvency framework and cross-border dispute resolution mechanisms, making them much more settled in this regard. Akin to Section 14 of the

[19] The Insolvency and Bankruptcy Code 2016, s 14
[20] Kanishka Bhukya, 'At the Crossroads of Insolvency and Arbitration: Which Way Forward?' (2022) 16 Rom. Arb. J 111.
[21] *Alchemist Asset Reconstruction Co Ltd v Hotel Gaudayan Pvt Ltd.* [2021] AIR 2017 SC 5124.
[22] *Annapurna Infrastructure Pvt. Ltd. & Anor vs. Soril Infra Resources Ltd* [2017] SCC OnLine NCLAT 380.

[23] *K.S. Oils Ltd. v State Trade Corpn. of India Ltd.* [2018] SCC OnLine NCLAT 352.
[24] *Reliance Commercial Finance Limited v Ved Cellulose Ltd. [2017] (IB)-156(PB)/2017.*

[25] P. *Mohanraj v Shah Bros. Ispat (P) Ltd.* [2021] 6 SCC 258, *Dena Bank v C. Shivakumar Reddy* [2021] 10 SCC 3307.
[26] *Power Grid Corpn. of India Ltd. v Jyoti Structures Ltd.* [2018] 246 DLT 485.

Code, the USA Bankruptcy Code imposes an automatic stay on all proceedings, including arbitration, when the bankruptcy is filed,[27] and renders those awards in contradiction with the stay void.[28] In considering the question of arbitrability of insolvency claims and allowing arbitration to proceed, the courts have endeavoured to make a distinction between "core" and "non-core" insolvency disputes,[29] wherein the "core" subject matter is reserved for insolvency courts and primarily emanates from the Code, and the matters within the purview of non-core include those that can be filed outside the Code,[30] including arbitration.[31] Thus, the courts have usually lifted the stay on arbitration proceedings involving non-core matters.[32]

However, there seems to be a lack of consistency in the decision of the Indian courts while emulating the same. The Apex court has categorically held that the NCLT has jurisdiction only to the extent of adjudicating matters concerning the insolvency of the corporate debtor.[33] Following a different line of reasoning, others have elaborated on the "residuary jurisdiction" of the NCLT under Section 60(5)(c) of the Code[34] which allows it to adjudicate upon all facts in issues arising from or in relation to insolvency proceedings.

While the contrast between the "core" and "non-core" matters is apparent, specific instances, such as those affecting the corporate debtor's value, can potentially broaden the ambit of the original jurisdiction of the Special Court. It may open Pandora's box that gives discretion to the NCLT in dealing with issues relating to the creditor and CD, leading to ambiguity in the distinction sought to be achieved. Thus, considering the recent *Gujarat Urja* judgment, its implementation and interpretation in Indian courts must be observed to draw a conclusive distinction between "core" and "non-core" matters to bridge the void in the moratorium provisions of the Code, deviating from the overarching reliance on its scope and objective.

**A Legislative Guide- The Need of the Hour**

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[27] 11 U.S.C, s 362 (a)

[28] *Acands Inc v Travelers Cas & Sur Co.* [2006] 435 F.3d 252,(3d Cir. 2006).

[29] *In Re Winimo Realty Corp.* [2001] 270 B.R. 99 (S.D.N.Y. 2001).
[30] *Hays & Co. v Merrill Lynch, Pierce, Fenner& Smith, Inc.* [1989] 885 F.2d 1149 (3d Cir.1989).
[31] *In re White Mountain Mining Co.* [2005] 403 F3d 164, 169 (4th Cir. 2005).
[32] *In re Bethlehem Steel Corp.* [2007] 479 F.3d 167 (2d Cir. 2007).

[33] *Gujarat Urja Vikas Nigam Limited v Amit Gupta & Ors*, [2021] 7 SCC 209.

[34] The Insolvency and Bankruptcy Code 2016, s 60(5)(c)

The Indian Judiciary has taken a progressive approach towards the controversy surrounding the arbitrability of insolvency disputes. It can be deduced through recent pronouncements that it has made a conscious effort to balance arbitration with insolvency proceedings, thereby preventing collision between them and adopting a global approach in this regard. However, India has yet to achieve better results, as shown on the 'Resolving Insolvency' index.[35]

Moreover, the pertinent question still remains inconclusive- Are all disputes pertaining to insolvency non-arbitrable? In the absence of statutory guidance on the interplay of these contrasting proceedings, several high-profile arbitration decisions have suffered hindrances due to the commencement of insolvency proceedings.[36] Hence, the author suggests that a defined legislative framework based on the USA Insolvency Model would eliminate the possibility of misuse of the existing conundrum by the parties and bring overall predictability and certainty to the system.

Although it allows debtors to initiate insolvency proceedings in contrast with India where it is primarily creditor-driven, the idea is to draw a distinction between "core" and "non-core" issues to determine the arbitrability of such matters. Therefore, the answer to whether all disputes are arbitrable lies in the fact that an insolvency proceeding that remains *in personam* if it assesses the liability of the corporate debtor shall be "deemed" as a non-core issue and determined by the arbitral tribunal. However, when the proceeding becomes a recovery suit, thereby transforming into an *in rem* action, it shall be treated as a core issue and be dealt with in an Insolvency Court. Since arbitration would be required to determine the liability of only the CD and its enforcement lies before the executing court, such contractual disputes shall be arbitrable even post-initiation of the insolvency proceeding.

Furthermore, the author proposes a third "residuary" category, which allows one to be cognizant of any claims pertaining to the arbitrability of insolvency matters that may arise in the future. While the idea of a "residuary" category seems like a draconian undertaking and may suggest the origin of severe dysfunction, a test to determine the deciding authority is plausible. Inspired by the McMohan test,[37] the issue would be examined based on the language, history, scope, and objective of the statute to decipher its arbitrability. In case of a dispute, the doctrine of harmonious construction can be employed such that both statutes are read in parlance and do not defeat the

[35] World Bank, 'Doing Business- Resolving Insolvency Score' (*World Bank*, 2020) <https://subnational.doingbusiness.org/en/data/exploretopics/resolving-insolvency/score >
[36] Wolfgang Kuhn, 'Arbitration and Insolvency' (2011) 5 Disp Resol Intl 203.
[37] *Shearson/AmericanExpress, Inc. v McMahon* [1987] 482 U.S. 220.

purpose of the other statute. The courts must also examine the reason behind the initiation of the insolvency proceedings. "Dressed up petitions" which have been purposely initiated to oust the arbitration agreement or disrupt the arbitration proceedings such that they are vexatious or *mala fide*, must not be admitted by the insolvency courts, as held by the Supreme Court in the case of *Rakesh Malhotra v Rajinder Kumar Malhotra.*[38]

Thu, the tripartite Policy Guide for harmonising arbitration and insolvency proceedings, which includes the determination of dispute as a "dressed up petition" or *bona fide* claim, followed by the existence of a valid arbitration agreement between the parties. If it is a *bonafide* claim, the courts shall proceed to identify whether the claim is a core or a non-core one, or falls under the residuary category. After such determination, the adjudicating body shall resolve the matter according to its laws.

With India's current focus on becoming a global arbitration hub, insolvency arbitration serves as a viable option for resolving cross-border creditor disputes. While the prescribed period for concluding an insolvency proceeding is 330 days, the average time taken to complete a process under the Code in 375 days.[39] The hybrid structure allows flexibility to the parties, as well as reduces the delay in insolvency proceedings.

In conclusion, the recommended solution allows for catalysing complicated issues concerning arbitration and the execution of arbitral awards vis-à-vis insolvency proceedings. It not only aligns with India's pro-arbitration policy but also advances an efficient system that replaces the convoluted stance of the Indian judiciary on the issue. It could help national courts and International Arbitration Tribunals to foster a uniform transboundary approach to the arbitrability of insolvency disputes, thereby benefiting the international business community at enormous and increasing lucidity in the International legal regime.[40]

[38] *Rakesh Malhotra v Rajinder Kumar Malhotra* [2015] 192 CompCas 516 (Bom).
[39] Rajiv Mani, 'Mediation in Insolvency Matters' (*IBBI*, 2020) <https://ibbi.gov.in/uploads/resources/1acc8439aab101c013221a481fe108a6.pdf >
[40] Stephan Madaus, 'The (Underdeveloped) Use of Arbitration in International Insolvency Proceedings' [2020] 37 J Int Arb 449.