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An Analysis of the Interplay between Arbitration and Insolvency Proceedings

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ABSTRACT

Arbitration is a process of alternate dispute redressal wherein the parties choose to have their disputes resolved by an arbitrator instead of approaching courts. It results in a private, binding and legally enforceable arbitral award. In India, the Arbitration and Conciliation Act, 1996, a composite piece of legislation, based on the 1985 UNICITRAL Model Law on International Commercial Arbitration and the UNCITRAL Arbitration Rules 1976, governs arbitration. It includes provisions for domestic arbitration, international commercial arbitration, enforcement of foreign award and conciliation. In the insolvency space, India introduced a paradigm shifting change in 2016 through the enactment of the Insolvency and Bankruptcy Code 2016. The Code was introduced to 'consolidate and amend the laws relating to reorganisation and insolvency resolution of corporate persons in a time bound manner for maximisation of value of assets of such persons to promote entrepreneurship, available of credit and balance the interest of all the stakeholders.' The relationship between Insolvency and Arbitration is one of clear and fundamental contrasts. By its very nature insolvency law seeks to give its proceedings in rem effect by centralising all the proceedings against a debtor to one jurisdiction thereby resolving the insolvency collectively and comprehensively. On the other hand, arbitration heavily promotes party autonomy. It gives rise to in personam proceedings and decentralised proceedings. While arbitration proceedings are barred by operation of S.14 of the Code which deals with moratorium imposed when the insolvency resolution process is underway, there have been cases wherein arbitration proceedings involving the financially stressed debtor have been allowed to continue. This intersection between arbitration and insolvency proceedings continues to evolve on a case-by-case basis.

In light of this interplay, the aim of this article is to study the effect arbitral proceedings have on insolvency proceedings and vice versa. The author will identify issues arising due to the conflicting nature of insolvency and arbitration laws and discuss the existing legal framework and jurisprudence of the Indian courts with relation to it. Finally, the author will offer comments and suggestions to ensure consistency and predictability in the legal position.

***Keywords**: Arbitration, Insolvency, parallel proceeding.*

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I. INTRODUCTION

"A *conflict of near polar extremes…bankruptcy policy exerts an inexorable pull towards centralization while arbitration policy advocates a decentralised approach towards dispute resolution*."[2]

With rapid growth of international business relations, traditional justice delivery systems i.e., courts were acknowledged as being too rigorous, time consuming and resource exhausting. This made necessary the invention of alternative dispute resolution methods which were flexible and time-saving. Arbitration is one such process of alternate dispute redressal wherein the parties choose to have their disputes resolved by an arbitrator instead of approaching courts. Arbitration is beneficial for those parties who prefer an out of court process that is less time consuming than the normal lengthy recourse to courts. The parties to the dispute refer it to one or more persons i.e., arbitrator and agree to be bound by their decision which is termed as the arbitral award.[3] Arbitration thus results in a private, binding and legally enforceable arbitral award. WIPO defines Arbitration as "*a procedure in which a dispute is submitted, by agreement of the parties, to one or more arbitrators who make a binding decision on the dispute. In choosing arbitration, the parties opt for a private dispute resolution procedure instead of going to court*."[4]

In India, the Arbitration and Conciliation Act, 1996, (hereinafter the 'A&C Act') a composite piece of legislation, based on the 1985 UNICITRAL Model Law on International Commercial Arbitration and the UNCITRAL Arbitration Rules 1976, governs arbitration. It includes provisions for domestic arbitration, international commercial arbitration, enforcement of foreign award and conciliation. The cornerstone of arbitration as an alternate dispute resolution mechanism is the principle of party autonomy. The jurisprudence of arbitration has long established that arbitration process arises from parties' consent and they have the freedom to opt. Parties are free to determine the conditions by which the arbitration agreement will be governed, the place of arbitration, laws to govern the substance of the dispute and laws to govern the procedure of the arbitration etc.[5] Indeed one of the reasons that arbitration is preferred over

[2] In re U.S. Lines, Inc., 197 F.3d 631 (2d Cir. 1999)
[3] Aditi Goyal 'Arbitration Law in India' (*via mediation centre*) https://viamediationcentre.org/readnews/NTUy/Arbitration-law-in-India- accessed on 18 April 2023
[4] 'Guide to WIPO Arbitration' (*WIPO, What is Arbitration?*) https://www.wipo.int/amc/en/arbitration/what-is-arb.html accessed on 18 April 2023
[5]Akash Singh and Nili Khandelwal 'Party Autonomy – A Grundnorm to Arbitration' (*Mondaq*, 18 November 2021) https://www.mondaq.com/india/trials-amp-appeals-amp-compensation/1132244/party-autonomy--a-grundnorm-to-arbitration accessed 18 April 2023

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traditional litigation in courts is this ability of parties to tailor each component of arbitration process to best meet their needs, subject to the law.

In the insolvency space, the enactment of the Insolvency and Bankruptcy Code in 2016 (hereinafter the 'Code') acted as a paradigm shifting move. Prior to its enactment the legal framework for insolvency matters was fragmented and complex with multiple overlapping legislations. The introduction of the Code brought uniformity to the insolvency laws in India by repealing obsolete legislations and subsuming the insolvency resolution process of companies, limited liability partnerships, partnerships and individuals under a single code. It thus created an easy and prompt market mechanism for insolvency resolution. The objective of the Code is to *'consolidate and amend the laws relating to reorganisation and insolvency resolution of corporate persons in a time bound manner for maximisation of value of assets of such persons to promote entrepreneurship, available of credit and balance the interest of all the stakeholders.*'[6] The Code provides for two broad processes for resolution of corporate stress - Corporate insolvency resolution process (CIRP) or Pre-packaged insolvency resolution process (PPIRP). In case of failure in rehabilitating the corporate debtor through a resolution plan the corporate debtor is liquidated (Liquidation). The Corporate insolvency resolution process typically begins with admission of an application filed by an entitled stakeholder, financial creditor, operational creditor or corporate debtor itself, in the event of default in repayment of a debt of an amount specified i.e., threshold amount of default.[7] The Code envisages a swift timebound resolution process with firm timelines prescribed. It also incorporates a creditor-in-control model of insolvency resolution which has positively impacted credit discipline in the country. The Code provides for a calm period termed as moratorium to enable the stakeholders to resolve the stress without fear of recovery or enforcement actions. The viability of the corporate debtor is assessed by a collective of creditors known as committee of creditors who endeavour to rescue it through a resolution plan. The Code has overriding effect over other laws in case of any conflict or inconsistency.

II. ARBITRATION PROCEEDINGS AND INSOLVENCY PROCEEDINGS

Through the overview of arbitration and insolvency process given above it is evident that they inhabit distinct worlds. The underlying cause of this divergence are the basic policy objectives of arbitration and insolvency processes respectively. Arbitration is based on the principle of party autonomy whereas insolvency proceedings are by their very nature collective proceedings

[6] Preamble, Insolvency and Bankruptcy Code 2016
[7] S. 4 Insolvency and Bankruptcy Code 2016 (Limit increased to Rs. 1 crore vide MCA Notification S.O. 1205(E) dated 24.03.2020)

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aimed at equally protecting creditors interest and effectively distribute debtors' assets. The former is based on decentralisation, individual choice and confidentiality whereas the latter is based on centralisation and publicity of all matters connected to the insolvent.[8]

Insolvency process tends towards collective proceedings with solutions that are acceptable to a majority of the corporate debtor's creditors and other stakeholders. Such collectivism is necessary for maximising the value of the debtors and its assets as in its absence there would be multiple individual actions for debt enforcement against the beleaguered financially stressed corporate. The assets would be enforced for debtors in a piecemeal fashion and the stakeholders who are unable to get a piece of the pie would be left wanting. The best outcome is achieved in insolvency resolution when the value of the debtors and its assets are maximised and the claims are dealt collectively and distributed rationally to ensure optimum return to the stakeholders. Thus, almost all insolvency regimes across the world encourage either voluntary collectivism or impose collectivism compulsorily. Furthermore, they recognise that individual actions against the financially stressed debtor would further expend its resources and eat away at the potential returns. The maximisation of returns is achieved by providing for an automatic stay on individual actions and imposing a requirement on the creditors to lodge their respective claims against the debtor in a consolidated process. Such consolidation would reduce the stress on the debtor, diminish multiplicity of proceedings against the debtors, avoid expending of already scarce company resources and also ensure that the insolvency process is completed in a timely manner.

In contrast to this, arbitration law flows from the principle of party autonomy. As an alternate dispute resolution method, it limits the involvement of the courts and gives parties control over the process. Arbitration is begun on the basis of an arbitration agreement entered into by the mutual consent of parties to the dispute and includes in its scope only the disputes mentioned in it. With regard to those disputes the jurisdiction of the courts is ousted. Party autonomy makes arbitration attractive to corporations as they have the option of having their disputes resolved by mechanisms which meet their needs without getting involved in unpredictable and lengthy court processes. Courts typically do not have the central role to play in the arbitration except in recognition and enforcement of arbitration agreements and awards. Such minimal judicial intervention is encouraged through legislations by business-friendly states and orders of judiciaries who uphold party autonomy rather than assuming jurisdiction themselves.

[8] Philip Wagner, 'Insolvency and Arbitration: A Pleading for International Insolvency Law (2011) International Dispute Resolution,189

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The principle of party autonomy is the factor which puts arbitration in variance with insolvency proceedings. Parties through an arbitration agreement choose to submit themselves to the jurisdiction of arbitrators and privately resolve their dispute but are force by the supervening incident of insolvency to submit to the jurisdiction of insolvency courts. In most cases it is the policy objective of insolvency which is to maximise the returns to stakeholders of the insolvent corporate which overpowers the policy objectives of arbitration law. When insolvency proceedings begin the automatic stay on individual enforcement actions against the corporate debtor comes into force. The parties in the *in personam* actions of arbitration are forced instead to subject themselves to the jurisdiction of the insolvency courts and in effect converts it to *in rem* proceedings.[9]

III. SCOPE OF STAY OR MORATORIUM UNDER INSOLVENCY PROCEEDING

A moratorium is defined as "*temporary suspension of an activity or law until future consideration warrants lifting the suspension, such as if and when the issues that led to moratorium have been resolved."*[10] It can also be defined as "*A legally authorized period of delay in the performance of a legal obligation or the payment of a debt"*[11]

Under the Insolvency and Bankruptcy Code 2016 moratorium is provided under S.14.It comes into force on the insolvency commencement date and continues till a successful resolution plan is enforced or the corporate debtor is liquidated. It allows the operations of the corporate debtor to continue and for any essential services and goods to be provided to the company without interruptions. It acts to stay/prohibit the following

"*…(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;*

(b) transferring, encumbering, alienating or disposing of by the corporate debtor any of its assets or any legal right or beneficial interest therein;

(c) any action to foreclose, recover or enforce any security interest created by the corporate debtor in respect of its property including any action under the Securitisation and

[9] Bishwajit Dubey, Radhika Dubey & Prafful Goyal, 'Arbitration and Insolvency: A Conflict of Near Polar Extremes: Contrary Perspective' (2022) in Ishaan Madaan & Christian Campbell (eds.) Crossroads of Insolvency and Arbitration Comparative Law Yearbook of International Business Special Issue, (The Centre for International Legal Studies, 2022)

[10] Adam Hayes, 'Moratorium: Definition: How It Works, Examples' (*Investopedia, 30 December 2022*) https://www.investopedia.com/terms/m/moratorium.asp accessed 18 April 2023

[11] Moratorium, (*Merriam Webster*) https://www.merriam-webster.com/dictionary/moratorium accessed 18 April 2023

Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;

(d) the recovery of any property by an owner or lessor where such property is occupied by or in the possession of the corporate debtor…."[12]

The purpose of such a moratorium is to give the insolvent debtor some breathing space to restructure the business and prevent a liquidation of the company. This judicially mandated calm period disallows creditors and other stakeholders from enforcing their claims against the debtor individually and thus dissipating its assets and overall value. The Bankruptcy Law Reform Committee whose recommendations were instrumental in setting up of the Code recommended and explained the motivation behind introducing a stay provision i.e. moratorium in insolvency proceedings.[13] It stated that moratorium allows for the operations of the financially stressed insolvent debtor to continue while its viability and survivability is under consideration in the CIRP process. This continued and uninterrupted operation permits value maximisation and prevents additional stress. This breathing space is not just provided against debt recovery actions but also from any claims from old or new lawsuits or any other manner of recovery from the insolvent entity.

IV. INTERACTION OF MORATORIUM WITH ARBITRATION PROCEEDINGS

From a bare reading of S.14 of the Code it is evident that arbitration proceedings are barred by the imposition of moratorium. The provision clearly states that "*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"*[14]. In the case of *Alchemist Asset Reconstruction Company v Hotel Gaudavan Pvt. Ltd.* The Supreme court was faced with a situation where arbitration proceedings were commenced against the corporate debtor after the insolvency application was admitted and moratorium was in place. The court stated that such arbitration proceeding would be *non est* in law.[15] Similarly continuation of any proceeding including arbitration proceedings which are pending during the commencement of insolvency would also be barred by the operation of the moratorium.

Though this general rule does not have statutory exceptions, there have been exceptions carved out through judicial pronouncements. As discussed earlier the purpose of the moratorium is to prevent dissipation of the corporate debtor's assets through numerous individual debt

[12] S. 14 Insolvency and Bankruptcy Code 2016
[13] Bankruptcy Law Reforms Committee Report Vol. 1, Para 5.3.1, (*November 2015*)
[14] S. 14, Insolvency and Bankruptcy Code 2016
[15] Alchemist Asset Reconstruction Company v Hotel Gaudavan Pvt. Ltd. (2017 SCC OnLine SC 1362)

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enforcement actions and allow for value of the corporate debtor to be maintained and possibly even maximised. Thus the blanket prohibition on institution or continuation of proceedings would only have value eroding effect if they were against the corporate debtor. Any proceeding instituted or continued by the corporate debtor would surely be for its benefit and with aim of value maximisation. In the case of *Power Grid Corporation of India Ltd. vs Jyoti Structures Ltd*[16]*it was held that proceedings which did not adversely impact the assets of the corporate debtor would not be barred by moratorium. The court allowed continuation of proceedings under S. 34 of the* Arbitration and Conciliation Act, 2015 and did not grant a stay on arbitration. Those proceedings would be deemed to be for the benefit of the corporate debtor r*ather than an action for recovery of debt form the insolvent. It is in sync with the provisions of the Code to allow the corporate debtor in position of claimant to continue or institute proceedings (including arbitration proceedings) to further bolster the value of the company and preventing the c*orporate debtor from pursing legal remedies for recovery of dues when under a moratorium, that same would defeat the very purpose of the Code.

Having established that any proceeding against the corporate debtor which would erode its value and defeat the collective insolvency proceeding is barred by moratorium whereas any proceeding by the corporate debtor which could aid in value maximisation could be continued or instituted regardless of the moratorium, an interesting question arises with regard to claims and counterclaims in the same suit or proceeding. The question would arise whether an arbitration proceeding should be allowed to continue or instituted wherein counterclaims are raised and there is a likelihood of these counterclaims being awarded against the corporate debtor. This question was deliberated upon by many tribunals in recent past[17]. In the case of *SSMP Industries Ltd. vs. Perkan Food Processors Pvt. Ltd.*[18] *The Delhi High Court held that there is no need to stay arbitration proceedings by application of S. 14 of the Code as the* corporate debtor would not face any adversity until the claims and counterclaims are being adjudicated upon. The arbitration proceedings could continue and upon determination of the counterclaims and claims S.14 could be selectively applied in the award enforcement stage. Those awards which reinforce interest of the corporate debtor could be enforced to maximise the value of its assets and those awards which diminish, dissipate the assets would be stayed by force of the moratorium.

[16] Power Grid Corporation of India Ltd. v. Jyoti Structures Ltd. (246 (2018) DLT 485)
[17] *Jharkhand Bijli Vitran Nigam Ltd. v. IVRCL Ltd (***2018 SCC Online NCLAT 891);** *Trading Engineers International Ltd. v. U.P. Power Transmission Corp. Ltd.* (**2022 SCC Online All 564)**
[18] *SSMP Industries Ltd. vs. Perkan Food Processors Pvt. Ltd.* **(2019 SCC Online Del 9339)**

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Another aspect where arbitration and insolvency proceedings interact albeit consecutively and not simultaneously is in determining whether an arbitration award could be considered as evidence to show debt and its default by the corporate debtor. The corporate insolvency resolution process can be begun by a financial creditor[19], operational creditor[20] or by the corporate debtor itself.[21] The financial or operational creditor must show that the corporate debtor has defaulted in repayment of the financial or operational debt respectively. Such a claim by the creditor must not be the subject of dispute nor should any proceeding be underway in determining whether such debt and default truly exists. An arbitration proceeding has two stages – pre- award and post award (enforcement). When dispute between parties has been arbitrated and an arbitral award made such an arbitral award can be used to initiate insolvency proceedings, provided the credit therein must be undisputed. In the case of *K. Kishan v. Vijay Nirman Co.*[22] the Supreme Court held that an arbitral award which acts as valid record of an undisputed debt could be used to initiate the corporate insolvency resolution process. However insolvency proceeding can only be begun on the basis of the arbitral award when proceedings for setting aside of the award has been rejected or dismissed or the limitation to set aside the award has expired. Debts under awards cannot be used to initiate insolvency proceedings when setting aside proceedings are pending or available.

V. CONCLUSION

From the above discussion it is clear that the relationship between Insolvency and Arbitration is one of clear and fundamental contrasts. By its very nature insolvency law seeks to give its proceedings *in rem* effect by centralising all the proceedings against a debtor to one jurisdiction thereby resolving the insolvency collectively and comprehensively. On the other hand, arbitration heavily promotes party autonomy. It gives rise to *in personam* proceedings and decentralised proceedings. [23]

In light of this fundamental policy variance the interplay of arbitration and insolvency proceedings throws up unique challenges and issues. This is of particular importance seeing that arbitration is foremost in business dispute resolution mechanisms and insolvency law has recently undergone a complete overhaul in the Indian jurisdiction. The recent Covid 19

[19] S. 7, Insolvency and Bankruptcy Code 2016
[20] S. 9, Insolvency and Bankruptcy Code 2016
[21] S. 10, Insolvency and Bankruptcy Code 2016
[22] K. Kishan v. M/s Vijay Nirman Company Pvt. Ltd (Civil Appeal No. 21825 of 2017)
[23]Philip Wagner, 'When Two Worlds Collide - The Dilemma between Insolvency and Arbitration', (2012), Yearbook on International Arbitration,119

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pandemic has exacerbated cases of multinational default and insolvency thereby necessitating a clarity in the position on interplay between arbitration and insolvency.

While arbitration proceedings are barred by operation of S.14 of the Code which deals with moratorium imposed when the insolvency resolution process is underway, there have been cases wherein arbitration proceedings involving the financially stressed debtor have been allowed to continue. This intersection between arbitration and insolvency proceedings continues to evolve on a case-by-case basis. The author has identified a subset of issues arising due to the conflicting nature of insolvency and arbitration laws. The examination of the existing legal framework and jurisprudence of the Indian courts with relation to it highlights the juridical interpretation. Further, legislative exposition on the issue and introduction of express provisions governing interaction of arbitration and insolvency would greatly aid in ensuring consistency and predictability in the legal position.

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