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The Arbitrability of Insolvency-Related Claims in Parallel to Ongoing Insolvency Proceedings

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ABSTRACT

Contractual claims, in which one party requests payment of a specific sum, are the most common source of commercial arbitration conflicts. This subject matter is, without a doubt, arbitrable in and of itself. When one of the parties declares bankruptcy, insolvency laws often require the insolvent party to undergo an authentication process overseen by national courts. Government policies regularly collide with international arbitration decisions. While arbitral tribunals emphasise the liberty of parties to choose whether or not to resolve their disputes through arbitration, states have a natural tendency to protect their territorial sovereignty and public policy. This paper talks about arbitration and its scope in the case of insolvency proceedings, how it is affected and what are the views of the international and national authorities on the subject matter. Through this paper, the authors have tried to convey the International and National standpoints on the issue of clash of arbitration and insolvency proceedings.

Keywords- *Insolvency Proceedings, Arbitration, International Arbitration, Bankruptcy Proceedings.*

I. INTRODUCTION

The expanding amounts of extreme bankruptcies in a variety of business hubs have refocused attention on critical jurisdictional issues deriving from the conflict between local insolvency regimes and parties' arbitration agreements on the one hand, and parties' arbitration agreements on the other. International arbitration frequently clashes with national policies. Whilst arbitral tribunals emphasise that parties have the ability to choose whether or not to settle their conflicts through arbitration governments have a natural desire to maintain their national authority and public policy.

The term "arbitrability" relates to whether or not a given disagreement can be resolved by

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arbitration. When a disagreement involves a public policy issue, national laws frequently prohibit the parties from presenting their disagreement to arbitration. When arbitral tribunals fail to consider such policy considerations, arbitral awards are highly likely to meet the "in-arbitrability chasm."

International arbitration and bankruptcy regulation produce extremely distinct legal procedures, each of which has specific purpose and policies. International arbitration and bankruptcy do not always get along. Arbitration is a decentralised method that establishes a right in personam, or against the individual, to enhance party autonomy in the resolution of disputes. By consolidating the proceedings against the debtor in a single jurisdiction, insolvency and bankruptcy procedures try to protect the debtor's third-party interests. A right in rem is created as a result. In the event of liquidation, the debtor's corporate existence is terminated, and reorganization is not possible until all ongoing claim processes against the debtor are resolved. When insolvency law and international arbitration intersect, arbitrators, parties, national courts, and arbitral institutions face a slew of challenges. When confronted with such a circumstance, a national court or arbitrator must decide whether a matter can be arbitrated or if a particular state's insolvency rules permit for state courts to have exclusive jurisdiction and power over the matter.

II. INTERNATIONAL APPROACH

Considering that international arbitration has become widely accepted as the standard procedure for resolving disputes resulting from foreign transactions, the relationship between bankruptcy and international arbitration is incredibly significant. For international commerce, trade, and investment, regulating the relationship between these two professions will become more essential.

Most legal systems include legal procedures to either rehabilitate or liquidate a corporation when it lacks the capacity to fulfil its obligations. Such legal procedures are usually codified by several nations in accordance with their laws and public policy by forming pieces of statutory legislations. These insolvency processes must take into account a variety of interests. The company (the debtor), the owners and management of the firm, creditors, workers, debt guarantors, and suppliers of products and services are all parties affected by insolvency proceedings. The statutory procedures governing bankruptcy must strike a balance not only between the various interests of the above parties, but also between these interests and important social, political, and policy issues that may influence the insolvency regime's economic and legal aims.

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When a firm trades across borders or operates in many nations, it faces complicated difficulties when it goes bankrupt. A corporation may acquire assets and enter into multiple foreign contracts throughout its existence. Arbitration provisions will be included in many of these multinational contracts. It was said in Mitsubishi vs. Soler Chrysler Plymouth[3] that "The concept of arbitrability is wider in the international context than in a national context". International arbitration and insolvency regulation gives rise to very different legal procedures, with each having its distinct purpose, objectives, and underlying policy[4]. The focus in insolvency regulation is on creditor equality, centralization of claims, insolvent party recovery, State control, transparency and accountability of the process, scheduled transfer of assets, and power typically derived from regulation. In the scenario of arbitration regulation, however, the authority stems from a contractual relationship between the parties (party autonomy that is independent of the State), and the focus is on the resolution of a specific dispute among (usually two) parties, and it is typically private and confidential.

When insolvency law and international arbitration clash, arbitrators, parties, national courts, and arbitral institutions face a slew of difficulties. To determine a specific problem, arbitrators must know which law to apply. Parties require confidence about the strategy that will be taken in order to make informed and reasonable business strategies.

The arbitration agreement is an independent obligation separable from any contract within which an arbitration agreement may be contained.[5] So, even if the parties' original contract expires or is declared illegal or unenforceable, the commitment to arbitrate typically continues. Multilateral conventions have been signed by nations to encourage the recognition and enforcement of international arbitration agreements and awards, as well as to provide for common principles of recognition and enforcement. The Geneva Protocol of 1923 and the Geneva Convention of 1927 were two key international treaties that established the necessary conditions for signatory states to recognise and enforce international trade. These measures have been credited with initiating modern international endeavours to promote and encourage international commercial arbitration.

The New York Convention (which supplanted the Geneva Protocol of 1923 and the Geneva Convention of 1927) has become the most important international instrument for facilitating and promoting international arbitration by providing a legal framework for the recognition and enforcement of international arbitration agreements. Arbitration agreements are defined as

[3] 473 U.S. 614 (1985)
[4] KIRGIS (2009) p. 505.
[5] MONESTIER (2001) p. 224

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"concerning a subject matter capable of settlement by arbitration" in Article II (1) of the New York Convention. The kind of issues that can be resolved by arbitration varies by jurisdiction. The New York Convention's Article V(2)(b) permits national courts to refuse enforcement of foreign awards if they are in violation of or conflict with the state's public policy. Insolvency law is seen as one of the backbones of states' economic and legal framework, creating certainty in the market and promoting economic stability and growth.[6] The New York Convention is an international statute, however, its application to any specific arbitration agreement or judgment is a matter for domestic (or national) law and the domestic (or national) courts of the site of enforcement. As a result, regardless of whether each country is a signatory to the same international convention, the impact of specific domestic insolvency legislation on the manner an arbitration agreement or award is acknowledged or enforced may differ between countries.

Article 177(1) of the Swiss Private International Law Act (PILA) governs arbitrability, establishing that every matter concerning a financial interest is arbitrable. An insolvent entity does not lose its power to be a party to arbitration procedures or to serve as a party in proceedings under Swiss law. If the foreign insolvent company retains legal capacity under the relevant regulations in its country of establishment, it will be eligible for arbitration process.

However, issues that are deemed "core" bankruptcy matters in Switzerland cannot be decided through the process of arbitration. Insolvency procedures, trustee appointments, creditor claim verification and acceptance, and administration of a company's reorganization or liquidation under the DEBA (Debt Enforcement and Bankruptcy Act) are all instances of "core" concerns. Matters revolving around such issues are generally considered as non-arbitrable. While topics relating to "core" insolvency procedures are not arbitrable in Switzerland, the majority of actions relating to bankruptcy proceedings are. Actions of a "mixed" nature have been labelled for these situations. The major concern is which types of disputes are deemed "mixed" and can be settled by arbitration. Proceedings concerning preferences, deceitful transfers, creditor admission for the schedule of claims, inclusion or exclusion of assets, set-off concessions, the determination of the class of creditors, creditor challenges to the schedule of the claims and claims to be paid directly from the estate instead of inclusion with the schedule, etc are some matters which are considered to have "mixed" nature and are usually considered to be arbitrable in nature.

The phrase "matter capable of settlement by arbitration" has been construed by Australian courts to focus on two separate issues- whether the arbitration clause's terms extend, as a matter

[6] UNCITRAL Guide on Insolvency Law, p. 10

of construction, to cover the claim in question and whether the contract's subject matter is "arbitrable," which is, "one related to rights that are not needed to be resolved only via the exercise of judicial power". This was observed in Tanning Research Laboratories v O'Brien[7].

In cases involving bankruptcy and insolvency, Australian courts have declined to suspend court proceedings where an arbitration agreement existed, without specifically declaring that certain situations are fundamentally inarbitrable. While most disputes under the Corporations Act (Cth) might be submitted to arbitration, Austin J[8] concluded that the parties could not refer matters about the winding up of a corporation to arbitration because it is a matter arising from statute and includes the interests of third persons.

In the United States, for example, bankruptcy courts frequently use "the core matter test" when dealing with problems regulated by both the US Bankruptcy Code and the Federal Arbitration Act. Courts generally assess whether the problem concerns a "core matter" in order to reconcile the opposing interests of these two pieces of law. The bankruptcy proceedings which usually fall under the bracket if “core” matters are considered non-arbitrable. Such proceedings involve the decision of national bankruptcy law that created rights that which could not have arisen in an different situation. In “non-core” situations, on the other hand, the court must compel arbitration.

Arbitral decisions show that arbitral tribunals take into account whether the insolvency declaration was issued at the seat of arbitration or in a jurisdiction foreign to the arbitration proceedings. It has been decided by several ICC (International Chamber of Commerce) tribunals that proceedings under them were not bound by insolvency procedures filed in a jurisdiction other than the seat of the insolvency proceedings[9]. Other ICC tribunals, however, have held that they must consider bankruptcy law rules in a country other than the arbitration's seat because the insolvency procedures were recognized in the seat nation.

In the United Kingdom, an insolvency proceeding does not prevent a party from pursuing arbitration. Fulham Football Club Ltd v Richards established this stance, with the court of appeal ruling in support of the arbitrability of a shareholder unfair prejudice claim. The arbitrability of insolvency law issues is also reliant on whether the case involves third-party rights, according to the court of appeal. Cases involving an order for the insolvent firm to pay

[7] (1990) 169 CLR 332
[8] ACD Tridon Inc v Tridon Australia Pty Ltd [2002] NSWSC 896
[9] ICC Award No. 6057 of 1991 in MOURE (2007) (seated in Syria, insolvency proceedings in France); ICC Award No. 4415 of 1984, Clunet 1984, pp. 952-956 (seated in Paris, insolvency proceedings in Italy); ICC Award No. 5996 of 1991, cited in MANTILLA-SERRANO (1995) p.57 (seated in Tunisia, insolvency proceedings in France); ICC Case No. 1350, Clunet 1975, p.931 (seated in Switzerland, insolvency proceedings in Austria); ICC Award No. 11028 of 2002, cited in Perret, p.45 (seated in Switzerland, insolvency proceedings in Thailand)

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its obligations, the determination of the estate's assets, or the schedule of claims, for example, would have an impact on third-party creditors and would not be arbitrable.

The UNCITRAL Model Law on Cross Border Bankruptcy, which incorporates rules on the handling of international insolvency proceedings, has been adopted in Australia, UK, and the US. While the UNCITRAL Model Law on Cross-Border Insolvency does not specifically address the issue of arbitrability, it puts a stay order on the commencement or continuation of individual actions or proceedings which concern the debtor's assets, rights, obligations, or liabilities, in the case of foreign insolvency proceedings by the virtue of Article 20.

The UNCITRAL Model Law on Cross-Border Insolvency's Guide to the UNCITRAL Model Law on Cross-Border Insolvency specifies in paragraph 145 that the word "individual actions" pertains to actions before an arbitral court or tribunal. As a result, when international insolvency procedures have been recognized, individual actions or processes before an arbitral tribunal must be suspended, limiting the capacity of arbitration proceedings to progress.

The above-mentioned judgments demonstrate that the courts of Australia, the United Kingdom, and the United States have attempted to bring legislative coherence and maintain an approach that is compatible with their respective arbitration laws' legislative procedure.

III. INDIAN APPROACH

Unlike the United States and the United Kingdom, Indian courts have taken a harder stance on the arbitrability of insolvency rules. The Insolvency and Bankruptcy Code, 2016 governs insolvency processes in India. There are no provisions in the Code that clearly state how bankruptcy procedures initiated under the Code will affect an arbitration process. Likewise, the Indian Arbitration and Conciliation Act, 1996, lacks any provision addressing the effect or impact of the initiation of a corporate insolvency resolution process (CIRP) or liquidation, the two most major forms of proceedings anticipated under the Code. The Code, on the other hand, specifies the effects of CIRP or eventual liquidation on the continuation/starting of judicial actions and prohibits them. This is also applicable for arbitration procedures. All ongoing and prospective claims are barred under CIRP; pending claims can continue under liquidation, but future claims are barred. Furthermore, the CIRP is not arbitrable once it has started (at least during the pendency of the insolvency resolution process). It was held by the Hon'ble Supreme Court in A. Ayyasamy vs A. Paramasivam & Ors[10], that "insolvency and winding-up matters" are not arbitrable.

[10] *(2016) 10 SCC 386*

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In Re United States Lines Inc[11], it was stated that it will become inarbitrable once insolvency proceedings had begun. Whereas insolvency is intended to centralize all the proceedings against a debtor in one jurisdiction and thus create third-party rights for all creditors, arbitration, on the other hand, promotes a decentralized approach and promotes the party's autonomy when stipulating a personal proceeding against a particular person. The court precedents have sufficiently settled that if a dispute subject is part of a proceeding in rem, then it is not arbitrary.

The idea is that, rather than a consensual arbitration between one creditor and the bankrupt debtor, the interests of all creditors can be fairly and appropriately represented in the insolvency processes.

In Indus Biotech Pvt. Ltd. vs. Kotak India Venture Fund & Ors[12] before the National Company Law Tribunal in Mumbai, Kotak India Venture sought insolvency proceedings against Indus Biotech Pvt. Ltd. for failing to redeem optionally convertible preferable shares under Section 7 of the Code. While the above insolvent request was considered by the court, Indus Biotech requested the NCLT to refer the arbitrations of its contested parties under Section 8 of the Arbitration Act and simultaneously request of arbitration petition under Section 11 of the Arbitration Act submitted before the Supreme Court in an attempt to solve their issues.

The NCLT rendered its assessment on the insolvency application and the application for Section 8 on June 9, 2020 and rejected both requests. The NCLT observes that under the code of the insolvency application, it is required to prove the occurrence of default. Based on the parties' facts and arguments, the NCLT held that no default has occurred. At the same time, the NCLT also observed the obligation of Courts, when an arbitration clause exists, to submit the Parties into arbitration. There was an attempt to reconcile the parties' views because the dispute was arbitrary, and the Agreement had an arbitration clause. As a result, the NCLT allowed the Section 8 application and denied the insolvency application, while noting that the request for arbitration is pending a Supreme Court ruling.

Kotak India filed a Special leave petition in the Supreme Court against the NCLT decision. On 26 March 2021, the Supreme Court gave the joint decision of both petitions. The Supreme Court in its opinion validated the NCLT Judgment, however by modifying its meaning and the rationale involved, maintained its dismissal of the Insolvency application against Indus Biotech. To conclude, despite the fact that it is a corollary to the application permitted by

[11] *197 F.3d 631, 640 (2d Cir. 1999)*
[12] Arbitration Petition (Civil) No. 48/2019

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Section 8, the Supreme Court has justified the NCLT's observation of the conflict referred to in Section 8 Application and its dismissal.

Application to determine insolvency would fall under Section 8, not vice versa. Rather than express an opinion on the NCLT's power to decide on Section 8 Applications directly, the Supreme Court took a different approach in its decision, stating that the NCLT does not need to consider the Section 8 Application separately from the Insolvency Application because the NCLT is required to first consider and examine the contentions raised in the Insolvency Application, and then to consider and examine the Section 8 Application. In either case, the Supreme Court decided that Section 8 applies as follows from the determination of an insolvency application:

If a "default" were determined and the debt paid, it would naturally lead to an application of insolvency and proceedings in rem against the debtor, as this would not raise an issue of the arbitrability of an inter-sector dispute between the parties and thus, would not be maintainable Section 8 and its requirements. In the event that a decision is made that there is no "default," the application for insolvency would be rejected, and the parties would have autonomy in the appropriate proceedings to secure the appointment of the arbitral tribunal as provided by law, and the NCLT would not have to pass any order under Section 8. As a result, the NCLT must first assess an insolvency petition while keeping Section 8 in mind.

While in the immediate Indus Biotech case the foregoing was not followed, the Supreme Court confirmed the NCLT's withdrawal from the application for insolvency. The Supreme Court observed that, in view of the facts and situations of the NCLT and its specific determination of no default made by Indus Biotech, section 8 was considered and dismissed the request. As a result, the Special Leave Petition challenging the NCLT's judgement was dismissed, and the arbitration petition for the appointment of arbitrators was granted.

IV. CONCLUSION

The disputes in the area of commercial arbitration emerge largely because of contractual claims when one party requests a particular amount of money. This is, of course, an arbitrary issue itself. In other words, bankruptcy rules normally require the insolvent party and its estate to proceed under a verification procedure by national courts or administrators if any of the parties is insolvent. Arbitral tribunals and national courts continue therefore to look to the following question in response: does the claim itself not become arbitrary when a party undergoes bankruptcy or insolvency because it is now connected to the amount of the estate of the bankrupt?

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Where, in general, international insolvency proceedings are recognized in a country, the arbitration proceedings that have their seat in that country should be initiated or continued in that country. It may indeed be that the arbitration proceeding would contravene the country's public policy. Similarly, if an arbitration award for enforcement is sought under a UNCITRAL cross-border insolvency law that recognises a foreign insolvency procedure, enforcement procedures must continue as long as they affect the debtor's assets, rights, or obligations.

Australia and England do not indicate which matters of insolvency are arbitrary and which are not. The US gives a non-exhaustive list of "essential" concerns but it is up to the Circuits to decide the discretion of bankruptcy tribunals and, so, what matters are arbitrary. Although it is not apparent exactly what insolvency issues in each common law country are arbitrary, it may be concluded that the primary insolvency issues under discussion in this study, i.e. cancelling transactions, disputing the schedule, and assessing the assets of the property, are not arbitrary. These jurisdictions utilize different nomenclature but eventually have the same strategy. Essentially, Common Law Countries make proceedings arbitrary, unless the proceedings involve third parties' rights or concern rights arising only in the insolvency proceedings or the statute governing the insolvency and bankruptcy law in the nation. In contrast, Switzerland's fundamental rule of arbitration, which stipulates that all property disputes are arbitrary, provides that most problems of insolvency are arbitrary. In particular, the key questions of insolvency investigated in this paper are arbitrary according to Swiss law, since they concern ownership interests.

State lawmakers have mainly ignored the issue, yet there are similarities between the relevant nations in terms of the arbitrability of insolvency processes. This lack of regulation gives rise to insecurity and uncertainty. Since international arbitration has become the 'normal' method of settling international disputes, a more definite, predictable, and consistent approach needs to be adopted to determine the arbitrability of insolvency disputes with the increasing spectre of insolvency proceedings, particularly in the current economic climate.

It is recommended that an international statutory guide on the arbitrability of insolvency procedures be formed, which could be used as a standard for national legislatures to alter their laws and regulations to address the issue of collision of insolvency proceedings and arbitration process. Arbitral tribunals may find this guidance valuable when faced with questions about the arbitrability of an insolvency matter.

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