INTERPLAY BETWEEN THE INSOLVENCY AND ARBITRATION LAWS IN INDIA: A DETAILED ANALYSIS

Srijoy Mukherjee[1]

Akanksha Srivastava[2]

ABSTRACT

The legal ambiguity created by the Supreme Court's ruling in the Indus Biotech case is examined in this article. The court determined that a company's capacity to employ arbitration, that is, a form of out-of-court dispute resolution with creditors may be impacted when it files for bankruptcy under the Insolvency and Bankruptcy Code. This is problematic since arbitration is permitted by other current legislation even in the midst of bankruptcy procedures.

The option suggested in the article is for the court to look into the real reason for the insolvency petition. Is it only an attempt to avoid arbitration or is it a real endeavor to resolve financial issues?

The article also addresses how to handle scenarios in which the creditor and the corporation are in debt to one another. It also makes the case that one arbitration effort that is denied shouldn't preclude a subsequent attempt to utilize a different strategy under a different legal provision.

In summary, this article advocates for a more clear legal structure in India to address scenarios involving both arbitration and insolvency.

Keywords: *Indus Biotech, Arbitration, Insolvency, Bankruptcy, creditors, debt*

[1] Srijoy Mukherjee, Student, B.A LL.B 5th Year, Christ (Deemed to be) University, Lavasa Campus, Pune, Maharashtra

[2]Akanksha Srivastava, Assistant Professor, Christ (Deemed to be) University, Lavasa Campus, Pune,Maharashtra

INTRODUCTION

Concerning Indus Biotech v. Kotak India Venture (Offshore) Fund case[3], there was a conflict between filing an application under Section 8 of the Arbitration Act and starting the insolvency process under Section 7 of the Insolvency and Bankruptcy Code. A disagreement emerged over the quantity of shares that the respondent-creditor would be eligible to receive as a result of the Optionally Convertible Redeemable Preference Shares ("OCPRS") conversion.

The creditor argued that the amount (equal to the share value) had become due and payable since the OCRPS redemption period had elapsed, and that failure to make the payment would result in a default on the obligation. In response, the creditor filed an application under Section 7 of the Code. The National Company Law Tribunal, Mumbai ("NCLT"), acting as the adjudicating authority, denied the application made under Section 7 of the Code and granted the request for arbitration under Section 8 of the Act. The issue of which application should be considered first, under Section 8 of the Act or Section 7 of the Code, both of which are unique provisions within their own domains, was subsequently appealed to the Supreme Court through a Special Leave Petition. The Honorable Supreme Court ultimately decided that since an Arbitration Petition filed by Indus Biotech Private Limited (the debtor) under Section 11 of the Act was already pending before the Court, it was appropriate to decide the case on merits, even though it did consider the argument of returning the case to the National Company Law Appellate Tribunal ("NCLAT") for appropriate procedure of appeal as per Section 61 of the Code.

Indus Biotech, the Supreme Court observed the following: a) an application filed under Section 7 of the Code would only become a proceeding in rem upon admission, not filing; b) however, if posed with an application under Section 8 of the Act, the Adjudicating Authority is required by Section 7 of the Code to first refer to the material before it in the application filed under Section 7 of the Code, even if the application under Section 8 of the Act is on record. This is because, if the application under Section 7 of the Code is admitted, the Supreme Court noted, the proceedings will become "procedures in rem, having erga omnes effect, due to which the question of

[3] 2021 SCC OnLine SC 268

arbitrability of the so-called inter-se dispute sought to be put forth would not arise,"[4] negating the need to decide the application under Section 8 of the Act.

Although the Supreme Court's ruling in the Indus Biotech case is regarded as a landmark decision and has been referenced by all courts and tribunals, the following legal concerns that arise from it need to be addressed:

Firstly, is the Adjudicating Authority entitled to rule on an application under Section 8 of the Act before ruling on an application for insolvency under Section 7 of the Code? Can the case of Vidarbha Industries Power Ltd v. Axis Bank Ltd[5] be read to allow for the use of the "dressed up" petition test within such a limited scope?

Second, in the summary proceedings that are being held before it, is the Adjudicating Authority the appropriate forum to rule on the existence and amount of the corporate debtor's counterclaim?

Third, as demonstrated in Koyenco Autos (P) Ltd v. BMW India Financial Services (P) Ltd[6], does the denial of an application under Section 8 of the Act serve as precedent for an application for the appointment of an arbitrator or arbitrators under Section 11 of the Act?

APPLICABILITY OF "DRESSED-UP PETITION" IN PROCEEDINGS UNDER THE INSOLVENCY AND BANKRUPTCY CODE

The courts have repeatedly encountered situations in which a financial creditor has exercised its right to file an application under Section 7 of the Code, the admission of which has rendered the dispute resolution clause redundant, despite a valid dispute resolution clause and an evident palpable dispute between the parties. As the Courts and Tribunals have repeatedly stated that a Section 7 of the Code application should not be used as a means of recouping debts; however, there is a paucity of judicial guidance regarding the tests that the Adjudicating Authority may use to uncover these hidden agendas and avert the needless start of the corporate insolvency resolution

[4] Indus Biotech (n 1) para 26.

[5] (2022) 8 SCC 352.

[6] ARB. P. 870/2011, Order dated 26-7-2022.

process ("CIRP"). Such ulterior intentions might include avoiding the inter se agreement's dispute resolution clause or using an insolvency petition to get a forced settlement with a corporate debtor.

An insolvency application file with a hidden agenda may be handled well by using the "dressed up petition" test. In order to determine whether a legitimate petition has been submitted or if it has been "dressed up" to evade the remedy that was agreed upon in the contract, the test requires the concerned forum to see through the petitioner's true intentions. Similar requirements would apply to proceedings under the Code, requiring the adjudicating authority to determine whether an application made under the guise of insolvency aims to evade the arbitration provision in an effort to profit from the ambiguity that a summary adjudication under the Code creates.[7] It is proposed that the Adjudicating Authority could guarantee that a dispute is referred to arbitration in deserving cases by using the test of a "dressed-up" petition, provided that the dispute falls within the purview of a valid arbitration clause and would suffer if CIRP is started in a summary manner.

The primary objection to using the "dressed up petition" test when deciding whether to grant insolvency application stems from the Supreme Court's ruling in Innoventive Industries Ltd v. ICICI Bank[8], which held that the Adjudicating Authority only needs to determine whether a "default" has been established under the Code. Although the aforementioned ruling is a classic on the scope of the Code's examination at the pre-admission stage, it's also important to remember that the Supreme Court held in the Vidarbha Industries case that the statute's title, "Insolvency and Bankruptcy Code," makes it abundantly clear that it addresses insolvency and bankruptcy. By initiating CIRP, the IBC most definitely does not intend to penalize solvent enterprises that have temporarily defaulted on their financial obligation payments. As a result, the Adjudicating Authority (NCLT) has the discretionary authority to accept an application for the start of CIRP submitted by a Financial Creditor in accordance with Section 7(5)(a) of the IBC.

The Supreme Court clarified in M. Suresh Kumar Reddy v. Canara Bank[9], that the decision in the Vidarbha Industries case was in setting the facts of the case before this Court, despite the fact that the two judgments appear to be at odds at first glance. As a result, it is impossible to interpret the

[7] Rakesh Malhotra v Rajinder Kumar Malhotra 2014 SCC OnLine Bom 1146: (2015) 192 Comp Cas 516.

[8] (2018) 1 SCC 407.

[9] (2023) 8 SCC 387 para 13

Vidarbha Industries judgment as holding a different opinion from that of Innoventive Industries. The perspective used in the Innoventive Industries case is still valid.

It is therefore contended that the Adjudicating Authority, when presented with an application under Section 7 of the Code, can decide whether or not the application is "dressed-up" because it is established that the Authority can consider considerations other than the establishing of a "default." In actuality, the test has been utilized several times by the Adjudicating Authority during its former incarnation as the Company Law Board ("CLB"). In the case of Vijay Sekhri v. Tinna Agro Industries Ltd.,[10] the petitioners argued that since the reliefs against oppression and mismanagement were outside the purview of an arbitration tribunal, the arbitration clause could not be invoked when an application under Sections 397 and 398 of the Companies Act, 1956 was filed, alleging oppression and mismanagement. Additionally, the petitioners argued that Section 402 of the 1956 Act limited the tribunal's statutory authority to provide the reliefs in the dispute. The argument that the proceedings under Sections 397 and 398 are outside the scope of arbitration would not stand, the CLB held, applying the test of the "dressed up petition" in this case. This is because there was a valid shareholders agreement, an arbitration clause, and the dispute originated from the shareholders agreement itself. In a similar stance, the CLB ruled in Airtouch International (Mauritius) Ltd v. RPG Cellular Investments and Holdings (P) Ltd.,[11] holding that, "... even in a Section 397/398 proceeding, if the party applying for referring the disputes to arbitration is able to establish that there are bona fide disputes arising out of an arbitration agreement and that the arbitrator could settle the disputes by appropriate reliefs, then, the CLB will have to refer the parties to arbitration in terms of Section 8 or Section 45 of the Act, 1996, as the case may be."

In addition, the petitioners in the Vijay Sekhri case contended that the petitioners were justified in moving to the CLB since it is the shareholders' statutory entitlement to do so in circumstances of tyranny and mismanagement and because the CLB cannot abdicate its statutory duties. However, the CLB held that, “all the ingredients of Section 45 of the Arbitration and Conciliation Act, 1996, are present. Once it is so, we feel that there is no further scope for us to take into consideration the arguments of Shri Singh about the statutory rights of the shareholders to move the Company Law Board, and that a specially constituted Tribunal cannot abdicate its jurisdiction, etc. We have to do

[10] 2010 SCC OnLine CLB 135: (2010) 159 Comp Cas 336 (CLB).

[11] SCC OnLine CLB 23: (2004) 121 Comp Cas 647 (CLB) para 6.

what the law mandates us to do. Section 45 requires us to refer the parties to arbitration and we have no discretion in this matter."[12] The aforementioned principles also apply to Section 8 of the Act. Although it may be argued that Section 238 of the Code takes effect upon filing of an application under Section 7 of the Code, the Supreme Court's ruling in the Vidarbha Industries case saves the day by giving the Adjudicating Authority a somewhat wider jurisdiction. The Supreme Court held that, "In the case of an application by a Financial Creditor who might even initiate proceedings in a representative capacity on behalf of all financial creditors, the Adjudicating Authority might examine the expedience of initiation of CIRP, taking into account all relevant facts and circumstances, including the overall financial health and viability of the Corporate Debtor. The Adjudicating Authority may in its discretion not admit the application of a Financial Creditor."[13] Consequently, it would be fair to state that the Adjudicating Authority has the option to additionally push the test of "dressed up petition" in service, based on the aforementioned decisions. Additionally, it should be remembered that not all cases provide such exceptional circumstances, therefore in the few instances that they do, it may be required to sort the wheat from the chaff when presenting the case facts to the adjudicating authority.

ADJUDICATION OF COUNTER CLAIMS

When the Adjudicating Authority receives an application under Section 7 of the Code, one of its initial actions is to determine whether a default has occurred. The information utility records or other supporting documentation provided by the financial creditor serve as the foundation for this decision made by the adjudicating authority. It is also important to note that any debt, even one that is contested, will still cause the adjudicating authority to designate it as a "default"[14] as long as it is past due. [15]

The only thing the adjudicating authority may do to determine a default is to determine if the obligation is "due and payable." Other concerns are not taken into consideration. For example, the Adjudicating Authority does not take into account any counterclaims that could have been made

[12] Vijay Sekhri (n 9) para 22.

[13] Vidarbha Industries (n 3) para 77

[14] "Default" is defined under Section 3(12) of the Insolvency and Bankruptcy Code.

[15] Innoventive Industries (n 6)

prior to or during the dispute's pendency. These counterclaims may be made and function as a "set-off," meaning that if the financial creditor's and the corporate debtor's claims are accepted, there won't be any more "dues" to be paid. Consequently, the goal of the pre-admission stage of the proceedings is to prevent any "moonshine defenses" that the corporate debtor raises from impeding the bankruptcy process, even if even significant defenses are sometimes disregarded in such a routine exercise.

Considering the aforementioned, a counterclaim may only be properly decided if it is brought before a civil court or arbitrated. Furthermore, it is made clear that Section 7 of the Code procedures become proceedings in rem only in the event that the application is accepted. Because the disagreement over the corporate debtor's default in light of the counterclaims is a dispute in personam, it can be arbitrated. If the adjudicating authority determines that the bankruptcy application is essentially a "dressed up petition," it must send these disagreements to arbitration. Furthermore, if a moratorium is declared, Section 14 of the Code prohibits any claim against the corporate debtor, particularly for the recovery of dues. As a result, the consideration for adjudicating authorities and courts changes. But it doesn't prevent a lawsuit brought by the corporate debtor or any other action taken "unless such action has the effect of endangering, diminishing, dissipating or adversely impacting the corporate debtor's assets." Thus, the corporate debtor may lawfully bring a counterclaim in a suitable venue, such as a civil court or arbitration, in response to or in opposition to any creditor's claim.

The case of Perkan Foods[16] raised the issue of whether to begin or continue with legal actions after admission. After the insolvency process had started, the plaintiff, a corporate debtor, filed an action of recovery in the Delhi High Court against a creditor who had a counterclaim against the plaintiff. It became unclear if the counterclaim's adjudication would be subject to a stay in light of Section 14 of the law. In this case, the plaintiff, a corporate debtor, made a claim that was so much larger than the defendant's counterclaim, a creditor, that, even if both claims were granted, the plaintiff would still be entitled to receive her money back from the defendant. Because of the summary process used there, the Delhi High Court held that determining the amounts of claims made by each party cannot be done by the NCLT. Instead, it would require thorough pleadings and an

[16] (CS(COMM) 470/2016 & CC(COMM) 73/2017)

analysis of the evidence, which would be more appropriate in a civil court or an arbitral tribunal. In the case of New Delhi Municipal Council v. Minosha India Ltd.,[17] the Supreme Court of India likewise adopted this stance.

Therefore, it might be claimed that the Adjudicating Authority is required by law to accept an application under Section 7 of the Code if a "default" under the Code is established, as a result of the Supreme Court's ruling in Innoventive Industries. But as was already indicated, the Coordinate Bench of the Supreme Court concluded in the Vidarbha Industries case that, contingent upon the facts and circumstances, an application under Section 7 may be denied or kept pending. "The adjudicating authority (NCLT) has been conferred with the discretion to admit the Financial Creditor's application," the Honorable Supreme Court ruled. The Adjudicating Authority has the authority to reject the application or keep the admission on hold if the circumstances and evidence justify If the Financial Creditor's outstanding payments persist, they will not forfeit their ability to reapply for the start of CIRP. Without the Authority rushing to admit an insolvency application, the application can be placed on hold and the disagreement over the claims and counterclaims can be suitably resolved by the arbitral tribunal.

DISMISSAL OF AN APPLICATION UNDER SECTION 11 OF THE ARBITRATION ACT ON PRIOR DISMISSAL OF APPLICATION UNDER SECTION 8 OF THE ACT- A PRECEDENT BAD IN LAW

As previously mentioned, a moratorium under Section 14 of the Code does not prevent a corporate debtor from suing. Nonetheless, the perspective presented in the Indus Biotech ruling confuses an additional facet of Indian arbitration law doctrine. In the aforementioned situation, the petitioner-debtor filed an arbitration petition in accordance with Section 11 of the Act, requesting the appointment of an arbitrator to settle the disagreements between the parties involved. The Supreme Court ruled that any outstanding applications filed under Section 8 of the Act will be rejected if it is determined that there is a default and that this is the foundation for admitting an application under Section 7 of the Code. As a result, there would likewise be no need for the court to decide the Section 11 application. The Delhi High Court used the same ruling in the Koyenco Autos case as well. The petitioner in Koyenco Autos filed the case in accordance with Section 11

[17] (2022) 8 SCC 384.

of the Act. One of the questions was whether the remedy under Section 11 of the Act would be barred by the original pending and final dismissal of an application under Section 8 of the Act. The Delhi High Court concluded that the petition under Section 11 of the Act could not be accepted since the application under Section 8 of the Act was made infructuous upon the admission of an application under Section 7 of the Code. This essentially eliminates the corporate debtor's ability to use arbitration against the financial creditor that filed the petition. Furthermore, this gives rise to an unusual situation whereby a corporate debtor may file a lawsuit or an arbitration petition under Section 11 of the Act while the moratorium is in effect. On the other hand, a previous Section 8 of the Act application dismissal, as was the case with Indus Biotech and Koyenco Autos, would mistakenly prevent the pursuit of a Section 11 application.

The logic of such a holding is very confusing. First, Section 8 of the Act and Section 11 of the Act have different forums for adjudication of applications. Secondly, an application under Section 8 of the Act is placed on hold while an application under Section 7 of the Code is decided. If an insolvency application is accepted, it may ultimately be dismissed as infructuous without being considered on its merits. Furthermore, if the aforementioned instances are to be followed, a dismissal of an application under Section 8 of the Act would not automatically result in the dismissal of an application under Section 11 of the Act. The legal stance that the corporate debtor may undertake any procedures for its advantage even during a moratorium would be violated by this. Because the dismissal of the former is not based on merits, there would be a greater legal danger if an application under Section 8 of the Act were to be treated as a precedent for resolving an application under Section 11 of the Act. In addition to disobeying the Supreme Court's major rulings and the notion of party autonomy, such a suggestion is illegal.[18]

CONCLUSION

The interaction between insolvency legislation and arbitration is covered in the article. The article examines Indus Biotech from a practical standpoint, considering the actual circumstances of what is and may occur if the Adjudicating Authority is presented with the aforementioned permutation and combination of circumstances. As a result, the article

[18] BALCO v Kaiser Aluminium Technical Services Inc (2016) 4 SCC 126; PASL Wind Solutions (P) Ltd v GE Power Conversion India (P) Ltd (2021) 7 SCC 1.

recommends using the "dressed up petition" test at the pre-admission phase to sort the wheat from the chaff and only let such cases to progress through CIRP in situations where there are no hidden agendas.

The importance of having a well-established insolvency legislation and procedure cannot be overstated, but Section 238 of the Code's primacy should not be interpreted incorrectly. When admitting an application under Section 7 of the Code, the adjudicating authority must recognize that the application is genuinely for the resolution of the corporate debtor and is not being made for any other or malicious purpose, disguising itself as an exercise of statutory right to avoid arbitration. Furthermore, since the Adjudicating Authority should accept the corporate debtor into bankruptcy upon discovering a default, the adjudication of counterclaims can be suitably handled by an arbitral tribunal without requiring the parties to settle their disagreement. Consequently, it would be crucial to ensure that an application under Section 11 of the Act is not rejected on the grounds that an application under Section 8 of the Act was previously dismissed. If this were to occur, this would also have an impact on the Code's overall goal of maximizing the value of corporate debtors. Therefore, before granting an application under Section 7 of the Code, the courts, especially the Adjudicating Authority, are urged by the article to take into consideration the ruling made by the Supreme Court in the Vidarbha Industries case and to give proper consideration to "disputed" defaults. By doing thus, the Adjudicating Authority would not be abdicating the statutory duties that have been assigned to it under the Code.

REFERENCES

- https://www.scconline.com/blog/post/2021/06/12/indus-biotech-v-kotak/
- https://www.jsalaw.com/articles-publications/the-interplay-between-international-arbitration-and-insolvency-proceedings-indian perspective/#:~:text=Insolvency%20and%20arbitration%20are%20fundamentally,arbitration%20advocates%20a%20decentralised%20approach.
- https://www.scconline.com/blog/post/2023/01/01/the-intersection-between-arbitration-and-insolvency-proceedings-an-indian-perspective/

- https://ibclaw.in/all-about-arbitration-vs-insolvency-the-interplay-between-insolvency-and-bankruptcy-code-2016-ibc-and-arbitration-and-conciliation-act-1996/
- https://www.juscorpus.com/wp-content/uploads/2022/10/101.-Lokesh-Patel.pdf
- https://www.ibanet.org/arb-insol-india
- https://rijbr.in/1/article/view/1171
- https://www.cbflnludelhi.in/post/arbitrability-of-insolvency-disputes-an-analysis-of-the-indus-biotech-case
- https://www.indianarbitrationlawreview.com/
- https://www.lakshmisri.com/insights/articles/contractual-claims-arbitration-and-the-insolvency-code-the-interplay-and-fault-lines/