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ARBITRABILITY OF DISPUTES UNDER INSOLVENCY LAW: INSPIRATION THAT INDIA CAN DRAW FROM FOREIGN JURISDICTIONS

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ABSTRACT:

Despite their obvious opposition, insolvency, and arbitration may overlap in some special circumstances to the point where legislation must be changed or, in the lack of legislation, judicial reflection is necessary. After the IBC 2016[1] was introduced, insolvency regulation in India underwent a paradigm change. The Code has been a powerful tool in shaping these processes into well-organized, time-bound proceedings, and its provisions have superseded all other laws, as stipulated in Section 238[2]. Our goal, in this case, is to first recognize that the CIRP as it is outlined in the Code—a widely publicized process that is sometimes burdensome in its technicalities—might not always be the best course of action or yield the most suitable result. Second, in the tried-and-true halls of arbitration, the concept of party autonomy may be added to CIRP. So, the idea is to provide a synergistic framework that combines the best features of both regimes.

KEYWORDS: Code, Arbitration, law, insolvency, corporate, conciliation.

INTRODUCTION:

The link between arbitration and insolvency has gained prominence lately with the implementation of new bankruptcy laws in India. The initiation of bankruptcy proceedings has resulted in the postponement of many arbitral hearings due to the lack of statutory guidance on the subject. India is a very recent addition to the list, even though other countries have established legal positions in this area.

2016 saw a significant revision to India's bankruptcy rules brought about by the IBC. Thus, other than the imposition of a moratorium, the Code contains no regulations outlining how the bankruptcy procedure might impact an arbitration. In addition, the Indian Arbitration and Conciliation Act, 1996[3] (the "Arbitration Act") does not specify the consequences of the CIRP

[1] Insolvency and Bankruptcy Code, 2016, No. 31, Act of Parliament (India)
[2] Insolvency and Bankruptcy Code, 2016, s 238 No. 31, Act of Parliament (India)
[3] Arbitration and Conciliation Act, 1996, No. 26 of Indian Parliament (India)

or liquidation under the Code. These issues will grow in significance when more commercial disputes in the post-Covid age start to occur.

Due to murky legislation and conflicting court rulings, this has turned into a grey area, requiring parties to contend with a range of problems. These include whether to commence arbitration proceedings immediately or to continue them from the beginning, how bankruptcy processes impact arbitrations conducted overseas, whether parties are permitted to participate in the bankruptcy resolution process, and how arbitral rulings about such proceedings are enforced. The two laws seem to conflict with one another, and it's not apparent where they intersect. A US court judgment has concisely described it as "a conflict of near-polar extremes: bankruptcy policy exerts an inexorable pull towards centralization while arbitration policy advocates a decentralized approach towards dispute resolution."[4]

CURRENT SITUATION: HOW INSOLVENCY AND ARBITRATION INTERACT:

One of the most difficult aspects of an arbitration-based bankruptcy procedure may be the stringent rulings made by the Indian Supreme Court about arbitrability. Arbitrability has two parts: procedural and substantive. Procedural arbitrability involves when an arbitration agreement lets the issue be arbitrated within its jurisdiction, while substantive arbitrability deals with whether the disagreement's subject matter is arbitrable under public policy.[5], the Supreme Court addressed this issue by formulating a four-part test, the first of which declares that the topic is not subject to arbitration in cases where the "cause of action and subject matter of the dispute relates to actions in rem, that do not pertain to subordinate rights in personam that arise from rights in rem."[6] This continues to be a critical point in any study that follows about arbitrating insolvency procedures. Nonetheless, the court acknowledged that some countries provide inter partes arbitrations concerning in rem rights via the use of a legislative framework. It then considered whether it might be implemented in India to support arbitration.

This makes it necessary to consider the many instances in which bankruptcy and arbitration are related to one another. The first scenario that may occur is if the corporate debtor is one of the parties to an ongoing arbitration action against which a Code-mandated insolvency application

[4] academia.edu, https://www.academia.edu/34694633/Insolvency_in_International_Commercial_Arbitration, (last visited Feb. 01, 2024).
[5] Vidya Drolia and Others v. Durga Trading Corporation, 2019 SCC Online SC 358
[6] Tariq khan & Mahi Mehta, The End Of A Saga- The Conundrum Of Arbitrability Of Landlord-Tenant Disputes, livelaw, (Feb. 01, 2024, 4:19 PM), https://www.livelaw.in/columns/tenancy-disputes-arbitrability-supreme-court-vidya-drolia-ii-tp-act-167352

is filed. In light of[7], which prohibits the persistence of any such behavior in any "arbitration panel" after a moratorium is proclaimed by the NCLT, the fate of such proceedings seems to be sealed until the CIRP is completed. Furthermore, the NCLT has ruled unequivocally that the commencement of a CIRP under the Code is unaffected by the ongoing nature of any such arbitral proceedings.

A second noteworthy overlap is that, as described in the above paragraph, which also forbids the establishment of such arbitration proceedings, parties may pursue arbitration processes after applying the Code. Although the statute is unambiguous about the declaration of a moratorium beginning on the date of bankruptcy, several rulings have helped us to better appreciate the situations in which there is no going back. In addition to[8], a [9] application under the Arbitration Act was made in[10]. In Given the Supreme Court has made it clear that an application filed under the Code does not automatically turn an insolvency action into an in-rem case and make it non-arbitrable. This only happens if the application is accepted, in which case a similar era omnes effect manifests and third parties get rights against all creditors. However, the court did make clear that parties may approach the authority for matters of withdrawal or settlement during the period following the admission of a petition and before the creation of the CoC, as long as they stay within the parameters of the inherent powers granted to them by Rule 11 of the NCLT Rules 2016. Consequently, the arbitration prohibition and the practical effect of the moratorium only take effect at the formation of the CoC, at which time the in-person activities become rem. It is important to remember that the court did not explore the authority of NCLT in an application made by[11]. Rather, it said that, without any independent evaluation of the former, the decision on the filing of the insolvency application under[12] the Code would be the only factor considered in the disposition of the former.[13]

[7] Arbitration and Conciliation Act, 1996, s 14(a), No. 26 of Indian Parliament (India)
[8] Arbitration and Conciliation Act, 1996, s 7, No. 26 of Indian Parliament (India)
[9] Arbitration and Conciliation Act, 1996, s 8, No. 26 of Indian Parliament (India)
[10] Indus Biotech Private Limited v. Kotak India Venture, MANU/ SC/0231/2021
[11] Arbitration and Conciliation Act, 1996, s 8, No. 26 of Indian Parliament (India)
[12] Arbitration and Conciliation Act, 1996, s 7, No. 26 of Indian Parliament (India)
[13] canada, https://www.canada.ca/en/revenue-agency/services/tax/technical-information/income-tax/income-tax-folios-index/series-3-property-investments-savings-plans/folio-3-capital-transactions/income-tax-folio-s3-f3-c1-replacement-property.html, (last visited Feb. 01, 2024).

In situations where there are conflicting legal issues, such as those involving contracts and bankruptcy, a system that prioritizes party autonomy is necessary. In these cases, characterizing the actions strictly as those in rem is not a practical solution. We thus believe that a mechanism is required whereby the NCLT may, upon request from the parties, submit them to arbitration. To enable the arbitration processes to begin and terminate within the auspices of the insolvency regime under the Code, appropriate legislative adjustments must be made. In this situation, a quantified framework for bankruptcy arbitration has been suggested, in which the arbitral tribunal supervises the insolvency procedure itself.

HOW DOES THE CODE FUNCTION?

The Code was enacted with the intention of "consolidating and amending the laws relating to reorganization and insolvency resolution of corporate persons in a time-bound manner," as well as to maximize asset value, encourage entrepreneurship, expand credit availability, and balance stakeholder interests. A corporate debtor that has relied on settlements from its creditors or a financial or operational creditor with unpaid liabilities totaling at least INR 1 crore, or USD 137,300, may file for bankruptcy before an NCLT, also known as the Adjudicating Authority under the Code, to start CIRP over the corporate debtor entity. An Interim Resolution Professional (to be replaced by a Resolution Professional) will be appointed to oversee the corporate debtor's operations throughout the CIRP period if the NCLT determines that the relevant debt has not been paid as promised. According to the Code, after the declaration of default, there must be public notice and the declaration of a moratorium, which forbids the corporate debtor from getting sued or having legal proceedings taken against it, as well as from having its assets transmitted, impeded, or disposed of. The CIRP cannot be arbitrated after it has begun, or at least not while the insolvency resolution process is still in progress. In[14], The Supreme Court said that arbitration does not apply to "insolvency and winding-up matters". Until the CIRP is completed, the moratorium order remains in force.

THE RANGE OF THE MORATORIUM MANDATED BY THE CODE:

The moratorium specifically prohibits "the institution of suits or continuation of pending suits or proceedings including the execution of any judgment, decree or order in any court of law,

[14] A. Ayyasamy v. A. Paramasivam & Ors (2016) 10 SCC 386

tribunal, arbitration panel or other authority" for the corporate debtor.[15] In India, enforcement action is also forbidden at the start of an insolvency process.[16] The court's rulings about The extent of the moratorium have been made clear by (i) asset maximization and (ii) protecting the business debtor's assets from harm.

According to the Supreme Court's ruling in the[17] Ltd held that the arbitrations and other legal actions taken after the CIRP's inception are deemed unenforceable. Despite the lack of legislative limitations, court decisions have established specific exceptions to the overall pattern. The arbitration process may go on as long as it (i) maximizes the value of the property owned by corporate borrowers and (ii) advances the company's debtor without lowering the value of the debtor's assets, according to the courts. or (iii) even if the proceedings are allowed to proceed, no attempt at repayment against the company's debtor may be undertaken during the moratorium.[18] Courts have sometimes refused to allow the filing of accusations or counterclaims against a corporate debtor to be postponed unless it can be shown that the debtor did not face any hardship. Any ongoing legal proceedings that were placed on hold due to the moratorium order may be resumed once the CIRP is completed and the moratorium is lifted. This is true even after the liquidation process gets underway.

The legal landscape shifts a little after a liquidation is initiated. A corporate debtor is not allowed to sue the liquidator or take any other legal action against them while the liquidation procedure is in progress after the liquidator has been appointed. Nonetheless, the liquidator may initiate legal action or file a lawsuit on behalf of the corporate debtor with NCLT's prior approval. Thus, it is not necessarily forbidden to take further legal action in the context of the corporate debtor's liquidation, including arbitration processes.

MORATORIUM ORDER'S EFFECT ON ARBITRATION PROCEDURES

The distinction between arbitration procedures that are ongoing and those that are started after bankruptcy proceedings begin is not acknowledged by the law. It doesn't provide a precise legislative process for getting rid of the Code's ban on starting or continuing arbitration proceedings. However, an arbitrating party may be able to request that the arbitration be

[15] Anjali Rathi and Others Versus Today Homes & Infrastructure Pvt. Ltd. and Others
[16] icsiiip.in, https://icsiiip.in/panel/assets/images/knowledge_capsules/16331593741467IBC_Knowledge_Capsule_18_(2).pdf, (last visited Feb. 01, 2024).
[17] Alchemist Asset Reconstruction Company v Gaudayan Pvt, AIR 2017 SC 5124
[18] Swiss Ribbons Private Limited And Another vs. Union Of India And Others

extended provided they can show that the arbitration was started in a way that would not negatively impact the corporate debtor's assets or maximize those assets. The clarity in this case would come from an NCLT judgment.

All arbitrations with seats in India are required to abide by the NCLT's decision to impose a moratorium. If an Indian party involved in a foreign-seated arbitration is being sued for bankruptcy, they might ask the foreign-seated arbitral tribunal to halt the arbitration process. Section 14 of the Code[19], which prohibits "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," may be interpreted as a general clause that would also apply in an arbitration with a foreign seat.

However, because the decision need not be bound by Indian law, there could not be any actual harm if a foreign-seated arbitration award is applied to foreign assets (outside of India). The reason for this is that India has not yet notified the reciprocating territories by Section 234 of the Code[20]. Thus, there may not be a barrier to the continuation of such arbitral operations until the courts at the arbitration's seat accept the bankruptcy proceedings. Public policy arguments will be made against the judgment's implementation, even in India alone, if the tribunal rejects the NCLT's decision to impose a moratorium.

IS THE ARBITRATION ACT SUPERSEDED BY THE CODE, OR VICE VERSA?

The NCLT addressed the important issue of which law takes priority in the case of a dispute in a recent verdict in Kotak India Venture Fund-I v. Indus Biotech Private Limited[21] and ordered the parties to arbitrate while the insolvency procedure was underway. The NCLT concluded that arbitration would supersede insolvency processes and protect solvent firms from CIRP in the case of a contractual dispute between parties that had an arbitration clause. The well-established idea that special law transcends regular law served as the foundation for this decision. Although dressed-up insolvency petitions are often used as a pressure tactic, to stall arbitration proceedings, and to prevent parties from working out their disputes, not every circumstance will profit from their consistent use. The arbitrability of insolvency petitions in India remains a contentious issue with no clear answers due to contradictory rulings and the absence of a Supreme Court ruling on the subject.

[19] Arbitration and Conciliation Act, 1996, s 14, No. 26 of Indian Parliament (India)
[20] Arbitration and Conciliation Act, 1996, s 234, No. 26 of Indian Parliament (India)
[21] Indus Biotech Private Limited v. Kotak India Venture, MANU/ SC/0231/2021

CONCLUSION:

One very intricate and advanced method of resolving disputes is arbitration. Insolvency arbitration, like other forms of arbitration, such as commercial, financial, marine, and sports arbitrations, will ultimately carve out a special place for itself while benefiting from the benefits that the arbitral system offers. Thus, it would also become a preferred recovery approach for companies facing financial difficulties; the COVID-19 pandemic would exacerbate this specific impact.

Without a doubt, party-appointed arbitrators who choose a chair arbitrator do not assure control over the selection of the arbitral tribunal under the existing CIRP under the Code. Furthermore, hearings may be easily scheduled by the parties at any time and place they want thanks to arbitration. Arbitration offers a flexible approach in addition to the time-bound framework of CIRP. This framework is similar to the time-bound nature of delivering an arbitral ruling within a year under Section 29A of the Act[22] in that it takes into account the date of the award when calculating the 330-day period within which the CIRP must be completed under the Code. Thus, the framework does not explicitly interfere with India's timetables for insolvency.

The secrecy of the arbitral process is one important issue that requires careful consideration. Confidentiality is a strong motivator for heavily indebted companies to prevent further declines in their market value, but business judgment seems to take a backseat when it comes to the need for public disclosure for requests to file claims and for answers to EOI requests. There are two ways to reconcile these opposing objectives. First off, private arbitration processes may protect the insolvent company and its image from scrutiny and public exposure. Second, the widely recognized concept of redacted arbitral papers and awards would win the day regarding the documents—and, more crucially, the award itself. Importantly, EOI responders must be bound by stringent secrecy agreements about the corporate debtor's financial information throughout the arbitration procedure. It is important to remember that the liberal view of who gets to decide on the in-rem rights implicated in the CIRP forms the foundation of the whole system. This is true even though it may appear that for companies wishing to transition from the present Code-mandated CIRP to one driven by arbitration, the secrecy of arbitration would be a deal-breaker in and of itself. Indus Biotech fundamentally changed the archaic

[22] Arbitration and Conciliation Act, 1996, s 29A, No. 26 of Indian Parliament (India)

understanding of the extent of arbitrability in bankruptcy. Even though it is liberal and ambitious, arbitration must recognize that in rem rights are decided solely by the CoC, with the NCLT only becoming involved in very extreme cases of irregularities, to combat insolvency in the wake of the COVID-19 pandemic and spearhead a global campaign towards a novel approach in business and commerce