

Can a credit contained in an arbitral award be used to initiate corporate insolvency resolution process under India's Insolvency and Bankruptcy Code, 2016?

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India's Supreme Court has held that a final judgment or decree from a court or tribunal serves as a valid proof of debt for initiating insolvency proceedings under the Insolvency and Bankruptcy Code, 2016. This article explains the framework of corporate insolvency resolution process, whether the credits contained in the arbitral award can be used to initiate the insolvency process under Indian law, whether there is a distinction between a foreign seated award and a domestic award in relation to the ability to use the credit for initiation of the insolvency process. It also explores the category of debt for claims arising from such awards. The article also examines how decree holders may opt for initiating insolvency proceedings instead of filing for enforcement and execution proceedings.

Introduction

Insolvency proceedings in India are governed by the Insolvency and Bankruptcy Code, 2016 (Code). The Code envisages corporate insolvency resolution process (CIRP) for the resolution of a debtor's insolvency. The National Company Law Tribunal (or referral to an Adjudicating Authority (AA)) has also been authorised to supervise CIRP and approve the resolution plan submitted by the incoming investor (also known as the Resolution Applicant) to revive the debtor.¹

There are no provisions in the Code which specifically stipulate the impact of the insolvency proceedings commenced under the Code on an arbitration proceeding, except for imposition of moratorium on pending and fresh litigation/arbitration on the commencement of a CIRP. Similarly, the Arbitration and Conciliation Act, 1996 (Arbitration Act) does not contain any provision reflecting the effect of the commencement of a CIRP or liquidation, which are the two most important types of proceedings contemplated

under the Code. Under the Code, a 'claim' means: (1) the right to payment regardless of whether such right is disputed, equitable, or unsecured; or (2) the right to remedy for breach of contract regardless of whether such a right is immature, disputed, equitable, or unsecured.² Whereas a 'debt' means a liability or obligation in respect of a claim which is due from any person.³

Under the Code, only a financial creditor or an operational creditor can initiate a CIRP.⁴ A financial creditor is defined as any person to whom a debt is owed which was disbursed against the consideration for the time value of money.⁵ An operational creditor is defined as any person to whom a debt is owed in respect of, inter alia, the provision of goods or services.⁶ If a corporate entity commits a default in the repayment of a financial debt which is due and payable, such a creditor can initiate a CIRP against the corporate debtor.⁷ However, in case of a default in the repayment of an operational debt, the AA is required to consider, in addition to the above requirements, whether there

is a pre-existing dispute between the creditor and the debtor.⁸ If the AA is satisfied that there is a pre-existing dispute between the parties, they may reject the creditor's application.⁹ Once the CIRP is admitted,¹⁰ an 'Insolvency Professional' is appointed, who oversees the CIRP. The Insolvency Professional makes a public announcement of the initiation of the CIRP against the debtor and calls for submission of claims in respect of the debtor.¹¹

Can the credit in an arbitral award be used to initiate a CIRP?

Domestic awards

In *K Kishan v Vijay Nirman Co (Kishan)*, the Supreme Court of India affirmed that even though arbitral awards are valid records of an operational debt, they would have to be undisputed to enable initiation of a CIRP by operational creditors.¹² This was the first case on the subject after the Code came into effect, and the law has evolved further since then. In *Kishan*, the Supreme Court concluded that there was a dispute related to the amount awarded in the arbitral award and refused to accept the CIRP application because: (1) a counterclaim exceeding the claim awarded was rejected by the arbitral tribunal on merits, and such a rejection is also subject to legal challenge; and (2) a challenge had also been filed against the arbitral award.

Kotak Mahindra Bank Ltd v A Balakrishnan (Kotak Mahindra) has held that a 'final' judgment,¹³ order or decree passed by a court/tribunal constitutes a valid proof of debt for initiation of CIRP under the Code. The AA allowed the creditor (Kotak Mahindra Bank Ltd) to commence CIRP against the debtor on the basis of a Recovery Certificate issued by the Debt Recovery Tribunal against the debtor in the recovery proceedings following the AA's decision. The debtor filed an appeal against the AA's decision before the Appellate Tribunal.¹⁴ The Appellate Tribunal allowed the debtor's appeal. The creditor then filed an appeal to the Supreme Court, which also observed that such a decree could be used as a proof of debt to initiate a CIRP within three years from the date of the decree. The Supreme Court further held that the nature of the creditor's underlying claim must determine the category of debt (ie, financial or operational) under which the decretal amount will fall. Since the creditor's claim qualified as a 'financial debt' before the adjudication, the creditor's claim following adjudication must also be classified as a 'financial debt' for determining the category of applicant. The ruling in *Kotak Mahindra* has been followed by courts and tribunals to allow commencement of CIRPs on the basis of a recovery certificate or a court decree.¹⁵

Foreign awards

Domestic awards are enforceable and executable as 'a decree of the court'. In the case of a foreign award must first be recognised under Indian law, according to sections 47 and 49 of the Arbitration Act.¹⁶ On recognition of the foreign award, and if the enforcement of such award is not resisted, it may be treated as an operational debt. If the enforcement of the award is resisted, then it would become disputed. However, there is not yet judicial precedent to support this position.

Recently, in *Trans Sea Transport B V v Lords Polymer [India] Private Ltd (Trans Sea)*, the AA rejected an application filed by a creditor seeking initiation of CIRP against Lords Polymer India Private Ltd (LPIPL).¹⁷ Prior to this application, certain contractual disputes between the creditor and LPIPL had been pursued through a foreign seated arbitration, culminating in an award in favour of the creditor. Subsequently, the creditor filed an application as an operational creditor seeking initiation of CIRP against LPIPL on the strength of the foreign seated arbitration award. The AA dismissed the creditor's CIRP application on the ground that a foreign award holder is first required to file a petition under Part II of the Arbitration Act and as such, a court alone is empowered to decide on the enforceability of the award.

Intriguingly, in *Agrocorp International Private (PTE) Ltd v National Steel and Agro Industries Ltd (Agrocorp)*, decided by AA in Mumbai, a similar application was filed seeking initiation of CIRP on the basis of an award in a United Kingdom-seated arbitration. The AA admitted the application despite the fact that the recognition/enforcement proceedings under Part II of Arbitration Act were pending.¹⁸ In this case unlike in *Trans Sea*, the foreign award was not challenged, and this was used as a basis to admit the insolvency petition. The AA further noted that the UK was a 'reciprocating country' under the Code of Civil Procedure, 1908 (CPC).¹⁹ Since any court decree in the UK would automatically become enforceable before India's courts, the AA held that the said foreign award can also be enforceable as a court decree.

There have been a series of cases by the Indian Supreme Court which have recognised that a foreign award has different stages relating to its enforcement. In the first stage, the Court would decide about the enforceability of the award having regard to the requirements of sections 47 and 48 of the Arbitration Act. Once the enforceability of the foreign award is decided, the Court would proceed to take further effective steps for execution of the award.²⁰ One may also argue in support of the decision and contend

that a foreign award, so long as it has attained finality at the seat of arbitration, is a valid proof of debt and can therefore be used by a foreign creditor to initiate insolvency proceedings in India.

In *Yes Bank Ltd v Sarga Hotels Pvt Ltd*, the National Company Law Tribunal (NCLT) also arrived at a similar view to *AgroCorp*.²¹ In this case, a creditor filed a claim during the CIRP based on a foreign award. The recognition/enforcement proceedings under the Arbitration Act were pending. The resolution professional admitted the creditor's claim as: (1) 'other debt' not financial debt; and (2) a contingent claim for a notional value. Aggrieved by the decision taken by the resolution professional, the creditor filed an application before the AA. The AA partially accepted the creditor's application by: (1) upholding the categorising of the creditor's claim as 'other debt'; and (2) directing the creditor's claim to be considered in its entirety as the claim had 'reached finality' in view of the foreign award.

The ruling in *Agrocorp* was not adhered to by the Hyderabad bench of the AA, in *Adityaa Energy Resource Pte Ltd v Simhapuri Energy Ltd*.²² The NCLT rejected the CIRP application on the basis that the foreign award had to be first recognised in accordance with the Arbitration Act before it could be relied as a valid proof of debt.

Key points from the court rulings

Initiating CIRP under the Code based on an arbitral award

FOREIGN AWARD V DOMESTIC AWARD

As outlined above, a foreign award must be recognised as a 'decree' before it can be used a proof of debt for initiating a CIRP under the Code. It is arguable that the order in *Agrocorp* incorrectly considered final foreign awards as executable court decrees in India for CIRP. Since the application seeking initiation of CIRP was subsequently withdrawn in *Agrocorp*, it has not been possible to see a final ruling on the said interpretation. However, the subsequent ruling in *Adityaa* suggests *Agrocorp* will not be followed.

At this juncture, it is also relevant to consider the definition of the term 'creditor' under the Code. A creditor is defined to include a 'decree holder'.²³ However, 'decree' is not defined under the Code. As a result, reference may be drawn to other statutes, including the Arbitration Act, which interpret the concept of 'decree'. On a combined reading of the Arbitration Act and the Code, unless a foreign award is recognised as a 'decree' under the Arbitration Act, the award holder cannot be categorised as a 'creditor' under the Code.

A domestic award is directly enforceable and executable as court decree. Therefore, a creditor who holds a domestic award in its favour, is entitled to initiate a CIRP under the Code on the basis of the domestic award alone. No separate enforcement proceedings are required before initiating a CIRP under the Code. In comparison, a foreign award first needs to be recognised as a court decree in accordance with the Arbitration Act.

OPERATIONAL CREDITORS V FINANCIAL CREDITORS

During a CIRP, a financial creditor enjoys greater participation in the preparation and approval of a resolution plan for the corporate debtor. It is therefore important to determine under which category of creditors an award holder would fall.

In *K Kishan v Vijay Nirman Company Pvt Ltd*, the Supreme Court stated that the filing and continuation of challenge proceedings implies that a 'dispute' between the parties continues to exist.²⁴ It is pertinent to recall that the Code prescribes the requirement of no 'pre-existing dispute' only for operational creditors. Consequently, even if there is an order, judgment or decree in favour of an operational creditor, such a creditor may not be able to initiate a CIRP until: (1) all challenge proceedings permissible under applicable law are dismissed; or (2) challenge proceedings are barred by limitation. An operational creditor may also base its claim on a foreign award. Therefore, a foreign award holder, which would fall under the category of operational creditor, can initiate a CIRP under the Code if the requirements are fulfilled.

However, there is no bar on financial creditors to file an insolvency application in case of a pre-existing dispute. Therefore, if a financial creditor has a favourable court decree or an arbitral award in a domestic arbitration, this could be treated as a valid proof of debt for initiating a CIRP under the Code.

Participating in the CIRP under the Code based on an arbitral award

FOREIGN AWARD V DOMESTIC AWARD

Following the commencement of the CIRP, the insolvency professional calls for submission of 'claims' in respect of the corporate debtor. In accordance with its definition under the Code, a 'claim' may be disputed, immature, or uncrystallised. Therefore, even if a foreign award is not recognised as a court decree under the Arbitration Act, it should fall within the scope of the word 'claim' of the Code. As a result, a foreign award holder should be able to file its claim

successfully in a CIRP. In *Sarga Hotels*,²⁵ the AA allowed the creditor's claim to be admitted in its entirety based on this interpretation.

OPERATIONAL CREDITOR V FINANCIAL CREDITOR

For an operational creditor, the requirement to establish the absence of a 'pre-existing dispute' is limited to the stage of initiating a CIRP. Once the CIRP has commenced, an operational creditor can file a claim even if the claim is pending adjudication. If the claim of the operational creditor arises from a foreign award, such a creditor can file a claim in the CIRP under the Arbitration Act regardless of the status of the enforcement proceedings.

Conclusion

There have been a series of judgments which have observed that insolvency proceedings cannot be used to circumvent execution proceedings and that creditors should not use CIRP as a method to recovery dues. However, with the Supreme Court judgment of *Kotak Mahindra*, a creditor may choose to initiate insolvency proceedings using an award or decree instead of proceeding with execution of such an award or decree. Subsequent decisions have clarified that the credit in an arbitral award should be undisputed (for an operational creditor) and that the award should be recognised as a court decree (in case of a foreign award).

A decision as to whether it would be beneficial for a creditor to initiate a CIRP instead of commencing execution proceedings under the Arbitration Act might depend on multiple factors. These include: (1) whether the debtor is saleable as a going concern; (2) whether the debtor is highly leveraged; (3) whether the creditor can financially support the CIRP; and (4) the nature of the arbitral award and the category of debt/claim. If the business operations of a debtor are such that a sale of the debtor as a going concern might not attract high enough bids, a creditor might choose to commence execution proceedings. If the debtor is highly leveraged, a creditor might not have a significant voting share in the committee of creditors; and, as such, is unable to influence the decision-making process in the committee of creditors meetings.

Notes

- 1 S 60 of the Code.
- 2 S 3(6) of the Code.
- 3 S 3(11) of the Code.
- 4 S 6 of the Code.
- 5 S 5(8) also defines 'financial debt' to include amount of any liability in respect of, inter alia, a guarantee, indemnity, capital/finance lease, amount raised from an allottee under a real estate project, etc.
- 6 S 5(21) defines 'operational debt' to include debt in respect of the obligatory payment to government under any law in force.
- 7 Part II of the Code (ss 4-54) provide for insolvency resolution process of a company (as defined under the Companies Act, 2013), an LLP (as defined under the Limited Liability Partnership Act, 2008).
- 8 S 8(2) of the Code.
- 9 S 9(5)(ii) of the Code.
- 10 CIRP commences on the date of admission of application filed by a creditor before the AA.
- 11 S 13 of the Code. After collation of all claims received against the corporate debtor, the insolvency professional constitute a committee of creditors (CoC).
- 12 *K Kishan v Vijay Nirman Co*, [(2018) 17 SCC 662].
- 13 *Kotak Mahindra Bank Limited v A Balakrishnan*, [2022 SCC OnLine SC 706].
- 14 National Company Law Appellate Tribunal (NCLAT) established under S 61 of the Code.
- 15 *Tottempudi Salalith v State Bank of India and Ors*, [(2024) 1 SCC 24]; *IOB v Ravi Cranes and Movers*, [2022 SCC OnLine NCLT 8461]; *Shubh Gautam v Anjani Technoplast Ltd*, [2022 SCC OnLine NCLT 4653]; *Tack Innovations and Ors v Autopal Industries Ltd and Ors*, [MANU/NC/1169/2023].
- 16 The provisions relating to arbitration under the Arbitration Act, are divided into two parts. Part I deals with India seated arbitrations. Part II contains provisions pertaining to recognition and enforcement of awards passed in foreign-seated arbitrations.
- 17 *Trans Sea Transport B V v Lords Polymer [India] Private Ltd*, [2022 SCC OnLine NCLT 281].
- 18 *Agrocorp International Private PTE Ltd v National Steel and Agro Industries*, [2020 SCC OnLine NCLT 6054].
- 19 Under S 44A of the CPC, a 'Reciprocating territory' means any country of which a court decree can be executed in India as a court decree by an Indian court.
- 20 *Fuerst Day Lawson Ltd v Jindal Exports*, [(2001) 6 SCC 356]; *Government of India v Vedanta Ltd & Ors*, [(2020) 10 SCC 1].
- 21 *Yes Bank Ltd v Sarga Hotels Pvt Ltd*, [2023 SCC OnLine NCLT 1051].
- 22 *Adityaa Energy Resource Pte Ltd v Simhapuri Energy Ltd* CP(IB) No 389/9/HDB/2018. The decision has been appealed before the NCLAT [Company Appeal (AT)(Ins) - 1038/2019] and is pending adjudication.
- 23 S 3(10) of the Code.
- 24 *K Kishan v Vijay Nirman Company Pvt Ltd*, [(2018) 17 SCC 662].
- 25 See n 21, above.

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