

Insolvency and Bankruptcy Hotline

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ARBITRAL AWARDS ARE VALID RECORDS OF DEFAULT UNDER THE INDIAN BANKRUPTCY CODE (ANNAPURNA V SORIL)

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Arbitration analysis: Moazzam Khan, co-head of International Dispute Resolution Practice and Siddharth Ratho, a member of the same team at Nishith Desai Associates consider the decision in *Annapurna Infrastructure Pvt Ltd v Soril Infra Resources Ltd* in which the National Company Law Appellate Tribunal of India (NCLAT) found that an arbitral award concludes the disputes between parties and is a valid record of default under the Indian Insolvency and Bankruptcy Code, 2016.

ORIGINAL NEWS

Annapurna Infrastructure Pvt Ltd & Anor v Soril Infra Resources Ltd, Company Appeal (AT) (Insolvency) No. 32 of 2017 (not reported by Lexis@Nexis UK)

The NCLAT held that:

- an arbitral award concludes the disputes between parties and is a valid record of default under the Indian Insolvency and Bankruptcy Code, 2016 (the IBC or Code)
- the pendency of proceedings for execution of an arbitral award or a judgment and decree does not bar an operational creditor from preferring any petition under the Code
- an insolvency resolution process is neither a money suit for recovery nor a suit for execution of any decree or award and is distinct from section 35 of the Arbitration and Conciliation Act, 1996 (the Arbitration Act) which relates to the execution of an arbitral award

The *Annapurna* case is yet another in a series of judicial precedents rendered by adjudicating authorities i.e. the National Company Law Tribunals (Adjudicating Authority or NCLT), under the Code which have provided much fodder for debate surrounding the interpretation of certain provisions in the IBC. This article, while discussing the recent *Annapurna* case, and the observations therein, explores the vagrancies in the judicial interpretation of the term 'dispute' and how the same has been settled to a certain extent.

WHAT IS THE SIGNIFICANCE OF THE TERM 'DISPUTE' UNDER THE IBC?

The term 'Dispute' defined in section 5(6) of the Code is as follows:

- '5 (6) "dispute" includes a suit or arbitration relating to –
- (a) the existence of the amount of debt;
- (b) the quality of goods or service;
- (c) the breach of a representation or a warranty.'

An existing 'dispute' falling within the above parameters bars the initiation of a corporate insolvency resolution process ('CIRP') against a corporate debtor and is thus a key remedy available to a corporate debtor under the IBC. When an operational creditor issues a demand notice to a corporate debtor under section 8 of the Code, the corporate debtor has the opportunity to, within ten days of receipt, bring to the notice of the creditor, the 'existence of a dispute' pertaining to the corporate debt, as provided for in section 8(2)(a) of the Code.

The phrase 'dispute in existence' thus also assumes significance as it is largely the only legal defence available to a corporate debtor to avoid insolvency or liquidation proceedings initiated by an operational creditor.

The survival of the corporate debtor therefore, to a large extent depends on whether there exists a 'dispute' concerning the claims of the operational creditor. It is therefore of no surprise that the term has been the focal point of interpretation in various orders of Adjudicating Authorities.

HOW HAS THE NCLAT SETTLED THE INCLUSIVE V EXCLUSIVE DEBATE?

Earlier in the year, the Delhi bench of the NCLT, in the matter of *One Coat Plaster, Shivam Construction Company v Ambience Private Limited Company Application No. (I.B.) 07/PB/2017*, held that the term 'dispute' needs to have a broad and inclusive definition and that it is not mandatory for the debtor to have initiated a suit or arbitration proceedings prior to the receipt of a demand notice, to be able to assert the existence of a dispute. Mere response to the demand notice showcasing the existence of a bona fide dispute shall suffice, it was held.

Conflicting decisions of Adjudicating Authorities interpreting the meaning of the term 'dispute' have been seen in *Essar Projects India Ltd v MCL Global Steel C.P. No. 20/I & BP/NCLT/MAH/2017*, where the Adjudicating Authority limited the meaning of 'dispute in existence' only to mean raising a dispute in a court of law or arbitral tribunal before

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the receipt of a demand notice under section 8 of the Code. A similar view was adopted in *Deutsche Forfait vs Uttam Galva Steel C.P. no. 45/I&BP/NCLT/MAH/2017* where it was held that the 'existence of a dispute' means that 'suit' or 'arbitration' proceedings must already be pending before an operational creditor serves a demand notice and that raising a dispute only in reply to the demand notice does not amount to notice of an 'existing dispute'. It was further held that even filing a suit or initiating arbitration proceedings subsequent to receipt of demand notice would not amount to an existing dispute.

The NCLAT in the case of *Kirusa Software Pvt Ltd v Mbbilox Innovations Pvt Ltd Company Appeal (AT) (Insolvency) 6 of 2017* put to rest the above mentioned conflicting views. Placing reliance on various judgments of the Supreme Court on interpretation of statutes, the NCLAT observed that the usage of the term 'includes' in the definition of 'dispute' enlarges the scope of the defined expression so as to also include its natural meaning, along with the statutory definition.

In light of the above, it observed that the scope of 'dispute' should cover all disputes, including proceedings initiated or pending before consumer and labor courts, mediation and conciliation, as well as if any action is taken by the corporate debtor under any act or law such as replying to a notice under section 80 of the Code of Civil Procedure, 1908, or an action under section 59 of the Sale of Goods Act, 1930, and not just be limited to suits and arbitrations. However, it also clarified that the dispute should have been 'raised in a court of law or authority and proposed to be moved before the court of law or authority and not any got up or mala fide dispute just to stall the insolvency resolution process', for it to fall within the expanded scope and ambit of the term 'dispute' under the Code.

WHAT WAS THE BACKGROUND IN THE ANNAPURNA CASE?

The appeal to the NCLAT was made by Annapurna Infrastructure Pvt Ltd and another (the Appellants) against an order dated 24 March 2017 ('Impugned Order') passed by the National Company Law Tribunal, Principal Bench, New Delhi ('NCLT Delhi'), whereby an application under section 9 of the Code for initiating CIRP against the corporate debtor was rejected on the ground that there was an existence of a dispute pending adjudication between the parties.

The 'dispute' had arisen between parties due to certain unpaid rents on the part of the corporate debtor, Soril Infra Resources Ltd (the Respondents), to the operational creditor, the Appellants, under a lease agreement. Accordingly, the Appellants had invoked arbitration against the Respondents and succeeded in obtaining a favourable award by way of which certain monies were due to them. The Respondents challenged the award. The challenge was subsequently dismissed by the High Court thus confirming the award. With the confirmed award as ammunition, the Appellants issued a demand notice dated 13 January 2017 under section 8 of the Code. The Respondents replied to the demand notice raising an objection on the ground that

there was an existence of dispute pertaining to the 'operational debt' sought to be recovered by the Appellants, in light of the pending execution of the award ("Execution") and the appeal under Section 37 ("Section 37 Appeal") of the Arbitration Act filed by the Respondents.

NCLT Delhi, in the Impugned Order, took a view that pendency of execution and the section 37 appeal would mean that the arbitral proceedings were yet to attain finality and as such there was 'existence of a dispute'.

NCLT Delhi further proceeded to observe that since the execution had already been initiated, an effective remedy was already being availed by the Appellants and that therefore a party could not invoke more than one remedy simultaneously as the same was against the fundamental principles of judicial administration. With these observations, NCLT Delhi rejected the Appellants petition under section 9 of the Code. The Appellants accordingly filed an appeal before the NCLAT.

WHAT WERE THE ISSUES FOR CONSIDERATION BEFORE THE NCLAT?

The issues raised for consideration by the NCLAT were whether:

- there is an 'existence of dispute' between the parties, after an award made by an arbitral tribunal has attained finality?
- pendency of execution proceedings of an award or a judgment and decree bars an operational creditor from initiating CIRP process under the Code?
- the Appellants are an 'operational creditor' within the meaning of Sec. 5(20) r/w Sec. 5(21) of the Code?

An Arbitral Award is a valid record of an event of default

The NCLAT undertook a scrutiny of section 8(2)(a) of the Code to make a distinction between 'existence of a dispute' and pendency of an application under section 34 or section 37 of the Arbitration Act. It considered the fact that in Form 5 of the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016 (the 2016 Rules), the order made by the arbitral tribunal is cited as one of the documents required to record an event of default. It observes that non-payment of the awarded amount thus amounts to a 'default' debt under the Code, to hold that an arbitral award, being a valid record of default, renders irrelevant the pendency of a section 34 or section 37 petition under the Arbitration Act, at least in terms of fulfilling the conditions for a complete application under section 9 of the Code.

Once the award stands confirmed, the 'dispute' ceases to 'exist'

Placing reliance on paragraph 6.001 of Russell on Arbitration (22nd edition) which states that 'in principle an award is a final determination of a particular issue or claim in the arbitration', as well as on the Supreme Court's decision in *Centrotrade Minerals & Metals Inc v Hindustan Copper Limited* (2017) 2 SCC 228 (not reported by Lexis@Nexis UK), the NCLAT observed that an award has finality attached to a decision on a substantive issue and concluded the dispute as to the specific issue determined in the award and disposes of parties' respective claims. The NCLAT then proceeded to analyse the scheme of the Arbitration Act to conclude that once the time period for challenging an award expires, or if the challenge is unsuccessful, the award becomes a decree, a valid proof of default, and consequently grounds for initiation of CIRP.

CIRP is not a money suit for recovery nor a suit for execution of a decree

Placing reliance on the preamble of the Code, the NCLAT clarified that an Insolvency Resolution process is not a money suit for recovery nor a suit for execution of any decree or award and is distinct from section 35 of the Arbitration Act which relates to the execution of an award. In light of the same, it was held that a CIRP can be initiated

for default of debt, as awarded under the Arbitration Act, irrespective of a pending execution as the same is separate and distinct from a CIRP and that therefore there is no question of a party trying to seek an alternative or a double remedy.

Quashing the Impugned Order

In light of the above observations, the NCLAT set aside the Impugned Order to hold the first two issues in favor of the Appellants. The NCLAT concluded that an award, once confirmed, is a finality and that pendency of execution or a section 37 appeal does not bar initiation of CIRP. Having observed so, the NCLAT accordingly remitted the case back to the Adjudicating Authority to decide on the third issue i.e. whether the Appellants are an 'operational creditor' and if so, whether the application under section 9 of the Code fulfills the requirement for admitting and initiating CIRP.

WHAT ARE THE PRACTICAL IMPLICATIONS?

As India looks to become a world beating economy in the 21st century, various reforms are being initiated in the regulatory landscape in the hope of making India a more attractive business destination. Given the general parliamentary impasse prevalent in the nation, regulatory reforms in recent times such as the IBC have been a welcome change and have catalysed the debt recovery scenario in the country, a much-needed shot in the arm to the Indian economy.

Modelled on the Bankruptcy Law of the United States, the IBC aims to move cases of company failure into a single forum, replacing an archaic system of overlapping regulations under which banks, company promoters and other creditors could all initiate competing proceedings in different courts, tribunals and regions and drag on the cases.

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— Siddharth Ratho & Moazzam Khan

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