INTERPLAY OF INSOLVENCY CODE AND ARBITRATION ACT – THE LEGAL CONUNDRUM EMANATING FROM *INDUS BIOTECH*

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ABSTRACT

The present article delves into the legal conundrum created by the judgment of the Supreme Court in Indus Biotech (P) Ltd v Kotak India Venture (Offshore) Fund,[1] *("**Indus Biotech**"). In Indus Biotech**,** the Supreme Court held that the consequence of an insolvency petition filed under the Insolvency and Bankruptcy Code, 2016 ("**Code**") (whether it is admitted or rejected on its own facts by the Adjudicating Authority) would fall upon the application under Section 8 of the Arbitration and Conciliation Act, 1996 ("**Act**") filed by the corporate debtor seeking reference of the dispute with creditor raised in insolvency petition to an arbitral tribunal. In the event, the insolvency petition is admitted, the application under Section 8 of the Act would stand dismissed. However, if the said petition is rejected, the Adjudicating Authority shall consider the application under Section 8 of the Act. Such being the case, it does not align with another extant legal position that an arbitration proceeding can be invoked and initiated by the corporate debtor for its benefit even during the corporate insolvency resolution process ("CIRP"). It is proposed in the present article that applying the test of "**dressed up petition**", the Adjudicating Authority may be able to resolve such conundrum at the origin by examining the real objective of the insolvency petition in light of the application seeking reference to arbitration under Section 8 of the Act. Subsequently, this article will also shed light on the adjudication of counterclaims by an appropriate forum in case of a dispute regarding the amount of default. Additionally, it*

1. *Indus Biotech (P) Ltd v Kotak India Venture (Offshore) Fund* (2021) 6 SCC 436.

will be contended that even if an application seeking reference to arbitration under Section 8 of the Act is dismissed, the same should not act as a precedent to the adjudication of an application under Section 11 of the Act, seeking appointment of arbitrator in terms of the agreement.

1. INTRODUCTION

Indus Biotech pertains to a tussle between the application under Section 8 of the Act and the initiation of insolvency proceedings under Section 7 of the Code. Here, the dispute arose as to the number of shares that the respondent-creditor would be entitled to, pursuant to the conversion of the Optionally Convertible Redeemable Preference Shares (**"OCPRS"**). However, the creditor contended that since the period of redemption of the OCRPS had completed, the sum (equivalent to the worth of the shares) had become due and payable, and the non-payment of the same would constitute a default of financial debt. Pursuant to this, an application under Section 7 of the Code was filed by the creditor. Correspondingly, an application under Section 8 of the Act was filed by the appellant-debtor, seeking to refer the parties to arbitration, as envisaged in agreements between them. The Adjudicating Authority, being the National Company Law Tribunal, Mumbai (**"NCLT"**) allowed the application for reference to arbitration under Section 8 of the Act and dismissed the application under Section 7 of the Code. The dispute was then appealed to the Supreme Court by way of a Special Leave Petition on the question of priority of consideration of the application under Section 8 of the Act and application under Section 7 of the Code, both being special provisions in their own realm. While the Hon'ble Supreme Court did consider the argument of relegating the case back to the National Company Law Appellate Tribunal (**"NCLAT"**) (for appropriate procedure of appeal as per Section 61 of the Code), the Court was ultimately of the view 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 deemed it fit to decide the case on merits.

The Supreme Court, in *Indus Biotech*, made the following observations: a) an application under Section 7 of the Code would convert into proceedings *in rem* only on the admission of the application, and not the filing of it; b) albeit, if posed with an application under Section 8 of the Act and that under Section 7 of the Code, the Adjudicating Authority is duty bound to *first* advert 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, the Supreme Court observed, was because if the application under Section 7 of the Code is admitted, the need to adjudicate the application under Section 8 of the Act would not arise, as the proceedings would then get transformed "*into proceedings in rem, having erga omnes effect, due to which the question of arbitrability of the so-called inter-se dispute sought to be put forth would not arise*."[2]

While the judgment of the Supreme Court in *Indus Biotech* is hailed as a landmark judgment and has been cited across all courts and tribunals, the following legal issues emanates from it which require attention:

First, is there any scope available to the Adjudicating Authority to decide an application under Section 8 of the Act prior to adjudication of an insolvency application under Section 7 of the Code? Can *Vidarbha Industries Power Ltd v Axis Bank Ltd*[3] ("***Vidarbha Industries***") be interpreted to avail such narrow scope to employ the test of "dressed up" petition?

Second, is the Adjudicating Authority the correct forum to decide substantial issue of the existence and the *quantum* of counter-claim of corporate debtor in the summary proceedings conducted before it?

Third, should the dismissal of an application under Section 8 of the Act be a precedent for an application for appointment of an arbitrator(s) under Section 11 of the Act, as seen in *Koyenco Autos (P) Ltd v BMW India Financial Services (P) Ltd*[4] (*"**Koyence Autos***")?

2. APPLICABILITY OF 'DRESSED-UP' PETITION IN PROCEEDINGS UNDER THE CODE

Time and again, the courts have been faced with a situation where notwithstanding a valid dispute resolution clause and an apparent palpable dispute between the parties, 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. While the Courts and Tribunals have iterated that an application filed under Section 7 of the Code should not be used as a debt recovery mechanism, however there is a dearth of judicial guidance on tests that may be employed by the Adjudicating

2. *Indus Biotech* (n 1) para 26.
3. *Vidarbha Industries Power Ltd v Axis Bank Ltd* (2022) 8 SCC 352.
4. *Koyenco Autos (P) Ltd v BMW India Financial Services (P) Ltd* ARB. P. 870/2011 Order dated 26-7-2022.

Authority to discover such ulterior motives, to prevent unnecessary initiation of corporate insolvency resolution process (**"CIRP"**). Such ulterior motives may be the instances of avoidance of the dispute resolution clause contained in *inter se* agreement, or to use an insolvency petition to obtain forced settlement with a corporate debtor.

The test of "dressed up petition" could be an effective way to deal with an insolvency application file with an ulterior motive. The test requires the concerned forum to see through the real intent of the petitioner as to whether a genuine petition has been filed or a "dressed up petition" in order to avoid the contractually agreed remedy. A similar applicability to proceedings under the Code would require the Adjudicating Authority to find if an application under the garb of insolvency, seeks to avoid the arbitration clause, attempting to benefit out of the uncertainty created by a summary adjudication under the Code.[5] It is submitted that employing the test of 'dressed-up' petition by the Adjudicating Authority could ensure that a dispute is referred to arbitration in deserving cases, provided that the dispute is within the realms of a valid arbitration clause which would otherwise suffer if CIRP is initiated in a summary manner.

The major argument against employing the test of "dressed up petition" at the stage of adjudicating an insolvency application is the view of Supreme Court in *Innoventive Industries Ltd v ICICI Bank* ("***Innoventive Industries***"),[6] that the Adjudicating Authority is merely required to see if a "default" is established in terms of Code. While the said judgment is *locus classicus* on the ambit of examination under the Code at pre-admission stage, it would also be worthwhile to note that the Supreme Court in *Vidarbha Industries* has taken a view that, "*The title "Insolvency and Bankruptcy Code" makes it amply clear that the statute deals with and/or tackles insolvency and bankruptcy. It is certainly not the object of the IBC to penalise solvent companies, temporarily defaulting in repayment of its financial debts, by initiation of CIRP. Section 7(5)(a) of the IBC, therefore, confers discretionary power on the Adjudicating Authority (NCLT) to admit an application of a Financial Creditor under Section 7 of the IBC for initiation of CIRP.*"[7]

5. *Rakesh Malhotra v Rajinder Kumar Malhotra* 2014 SCC OnLine Bom 1146 : (2015) 192 Comp Cas 516.
6. *Innoventive Industries Ltd v ICICI Bank* (2018) 1 SCC 407.
7. *Vidarbha Industries* (n 3) para 81.

While the two judgments seem contradictory at a glance, however in yet another judgment i.e., *M. Suresh Kumar Reddy v Canara Bank*,[8] the Supreme Court has clarified that "..... *by the order in review that the decision in the case of Vidarbha Industries was in setting of facts of the case before this Court. Hence, the decision in the case of Vidarbha Industries cannot be read and understood as taking a view which is contrary to the view taken in the cases of Innoventive Industries and E.S. Krishnamurthy. The view taken in the case of Innoventive Industries still holds good.*"

Therefore, since it is established that the Adjudicating Authority can look into factors beyond the establishment of a 'default', it is argued that the Adjudicating Authority, when faced with an application under Section 7 of the Code, can determine whether the application is 'dressed-up' or not. In fact, the Adjudicating Authority, in its previous avatar as the Company Law Board ("**CLB**"), has used the test on multiple occasions. In the case of *Vijay Sekhri v Tinna Agro Industries Ltd*[9] ("***Tinna Agro***"), when an application under Section 397 and 398 of the Companies Act, 1956 ("**1956 Act**") was filed, alleging oppression and mismanagement, it was contended by the petitioners that the reliefs against oppression and mismanagement were beyond an arbitration tribunal, the arbitration clause could not be invoked. The petitioners also contended that the reliefs in the dispute can only be granted by the tribunal exercising its statutory power under Section 402 of the 1956 Act. The CLB, using the test of "dressed up petition" in this case, held that since a valid shareholders agreement and an arbitration clause existed and that the dispute arose from the shareholders agreement itself, the argument that the proceedings under Section 397 and 398 are outside the purview of arbitration would not stand. Similar stand was taken by the CLB in the case of *Airtouch International (Mauritius) Ltd v RPG Cellular Investments and Holdings (P) Ltd,*[10] wherein it was held 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.*"

8. *M. Suresh Kumar Reddy v Canara Bank* (2023) 8 SCC 387 para 13.
9. *Vijay Sekhri v Tinna Agro Industries Ltd* 2010 SCC OnLine CLB 135 : (2010) 159 Comp Cas 336 (CLB).
10. *Airtouch International (Mauritius) Ltd v RPG Cellular Investments and Holdings (P) Ltd* 2003 SCC OnLine CLB 23 : (2004) 121 Comp Cas 647 (CLB) para 6.

Furthermore, the Petitioners, in *Vijay Sekhri*, also argued that since it is the statutory right of the shareholders to move the CLB in cases of oppression and mismanagement, and that the CLB cannot abdicate its statutory duty, the petitioners were justified in moving to the CLB. 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 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.*"[11] The said principles are applicable even for Section 8 of the Act as well. While it can be contended that once an application under Section 7 of the Code is filed, Section 238 of the Code comes into play, the judgment of the Supreme Court in the case of *Vidarbha Industries* comes to rescue, providing a slightly enlarged scope for the Adjudicating Authority. 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.*"[12] Therefore, relying on the above-mentioned judgments, it would be appropriate to say that the Adjudicating Authority has the discretion to also press in service the test of "dressed up petition". It is also to be kept in mind that such unique situations does not arise in all matters, but in rarity when such case facts are posed before the Adjudicating Authority, it would be necessary to separate wheat from the chaff.

3. ADJUDICATION OF COUNTER CLAIMS

One of the first steps that the Adjudicating Authority takes, when seized of an application under Section 7 of the Code, is to ascertain whether there exists a default. Default, as defined under Section 3(12) of the Code, is the "*non-payment of debt when whole or any part or instalment of amount of debt has become due and payable and is not [paid] by the debtor or the corporate debtor, as the case may be*". This, the adjudicating authority

11. *Vijay Sekhri* (n 9) para 22.
12. *Vidarbha Industries* (n 3) para 77.

does basis the records of information utility or on the basis of any evidence furnished by the financial creditor.[13] What is also significant to mention here is that any debt, including a ***disputed debt***, as long as due, would still prompt the Adjudicating Authority to term the debt as a 'default'.[14]

The Adjudicating Authority's scope in the ascertainment of the default is limited to whether there is a debt 'due and payable'. It does not take into consideration any other objections. For instance, the Adjudicating Authority does not consider any counterclaims that may exist before or during the pendency of the dispute. These counterclaims may exist and operate in terms of a 'set-off': if the claim of both the financial creditor and the corporate debtor are allowed, then there would be no 'dues' remaining to be paid. Therefore, the objective of proceedings at pre-admission stage is to disallow any 'moonshine defenses' raised by the corporate debtor to obstruct the insolvency proceedings, albeit in such routine exercise, even substantial defenses get overlooked.

Given the above, the proper adjudication of a counter-claim is possible only if relegated to a civil court or subjected to arbitration. It is also clarified that the proceedings under Section 7 of the Code transform to proceedings *in rem* only if the application is admitted. Therefore, since the dispute regarding the default of the corporate debtor, in light of the counter-claims, is a dispute *in personam*, the same is arbitrable and the Adjudicating Authority, if it finds that the insolvency application is in the nature of a "dressed up petition", must refer such disputes for arbitration, instead. Besides, the consideration for Adjudicating Authority and Courts changes in a post-admission stage as Section 14 of the Code bars any suit (especially for the recovery of dues) against the corporate debtor once moratorium is imposed. However, it does not bar any suit instituted by the corporate debtor, or any proceeding "*unless such proceeding has the effect of endangering, diminishing, dissipating or adversely impacting the assets of the corporate debtor.*"[15] Therefore, any counterclaim by the corporate debtor with respect to or against any claim made by a creditor can be appropriately pursued before an appropriate forum, including an arbitration or a civil court.[16]

13. The Insolvency and Bankruptcy Code, 2016 (31 of 2016) s 7.
14. *Innoventive Industries* (n 6).
15. The Insolvency and Bankruptcy Code, 2016 s 14.
16. *SSMP Industries Ltd v Perkan Food Processors (P) Ltd* 2019 SCC OnLine Del 9339 : (2019) 177 DRJ 473.

The question regarding initiation or continuation of proceedings in a post-admission stage came up in the case of *Perkan Foods.*[17] In this case, the plaintiff, which was the corporate debtor, filed a suit of recovery against a creditor, who had a counterclaim against the plaintiff, in the High Court of Delhi, after the insolvency process had already commenced. The question arose whether adjudication of the counterclaim would be liable to be stayed in view of Section 14 of the code. Here, the claim made by the plaintiff-corporate debtor was far greater than the counterclaim made by the defendant-creditor, to the extent that if both the claims were allowed, the plaintiff would still be entitled to recovery of dues from the defendant. Therefore, it was held by the Delhi High Court that the ascertainment of the claim amounts of both parties cannot be done by the NCLT (for the reasons of summary process followed there), and would require detailed pleadings and examination of evidence, which could appropriately be conducted before a civil court or an arbitral tribunal. Such view was also taken by the Supreme Court of India in the case of *New Delhi Municipal Council v Minosha India Ltd*[18] In this case, the question that the Court sought to address was whether the period under moratorium would be excluded in case of a suit/application filed by the corporate debtor. In answering this question, the Court held that "*Under the IBC, by virtue of the order admitting the application, be it under Sections 7, 9 or 10, and imposing moratorium, proceedings as are contemplated in Section 14 would be tabooed.* ***This undoubtedly does not include an application under Section 11(6) of the 1996 Act by the corporate debtor or for that matter, any other proceeding by the corporate debtor against another party.*** *At least there is no express exclusion of the jurisdiction of the Court or authorities to entertain any such proceeding at the hands of the corporate debtor.*"[19]

It can, thus, be argued that owing to the Supreme Court's decision in *Innoventive Industries*, the Adjudicating Authority has to mandatorily admit an application under Section 7 of the Code if 'default' under the Code is established. However, as mentioned above, the coordinate bench of the Supreme Court in the case of *Vidarbha Industries* held that an application under Section 7 can be kept in abeyance or be rejected, depending on the facts and circumstances. The Hon'ble Supreme Court held that, "*The Adjudicating Authority (NCLT) has been conferred the discretion to admit the application of the Financial Creditor.* ***If facts and circumstances so***

17. ibid.
18. *New Delhi Municipal Council v Minosha India Ltd* (2022) 8 SCC 384.
19. *New Delhi* (n 18) para 24.

warrant, the Adjudicating Authority can keep the admission in abeyance or even reject the application. *Of course, in case of rejection of an application, the Financial Creditor is not denuded of the right to apply afresh for initiation of CIRP, if its dues continue to remain unpaid*." Since the application can be kept in abeyance, the dispute surrounding the claims and counterclaims can be appropriately adjudicated by the arbitral tribunal without the Authority hastening to admit an insolvency application. This would give the parties an equal chance to present their claims and defenses, and allow the parties to adduce evidence, something that cannot be done in a summary proceeding before the Adjudicating Authority.

4. DISMISSAL OF AN APPLICATION UNDER SECTION 11 OF THE ACT ON PRIOR DISMISSAL OF AN APPLICATION UNDER SECTION 8 OF THE ACT – A PRECEDENT BAD IN LAW

As captured above, moratorium under Section 14 of the Code does not bar suits by the Corporate Debtor. However, the view expressed in *Indus Biotech* judgment confounds another aspect of the jurisprudence surrounding arbitration law in India. In the said case, an arbitration petition was filed by the petitioner-debtor under Section 11 of the Act, seeking appointment of an arbitrator to adjudicate upon the disputes between the concerned parties. The Supreme Court held that if it is found that there exists a default, and basis that an application under Section 7 of the Code is admitted, then any pending application filed under Section 8 of the Act would be dismissed. Consequently, the need for the court to adjudicate the application under Section 11 would also not arise. The same was also followed in the case of *Koyenco Autos* by the Delhi High Court. In *Koyenco Autos*, the petition was filed by the Petitioner under Section 11 of the Act. While there were various issues, one of the issues was whether the initial pendency and ultimate dismissal of an application under Section 8 of the Act would bar the remedy under Section 11 of the Act. It was held by the Delhi High Court that since the application under Section 8 of the Act was rendered infructuous on the admission of an application under Section 7 of the Code, the petition under Section 11 of the Act could not be allowed. This effectively neutralizes the scope of arbitration by the corporate debtor against the petitioning financial creditor. Additionally, this creates an anomalous position as a corporate debtor can file a suit or an arbitration petition under Section 11 of the Act during moratorium, however, a prior dismissal of an application under Section 8 of the Act, as per *Indus Biotech* and *Koyenco Autos*, would erroneously act as a bar to pursue Section 11 application.

The logic of such a holding, in the opinion of the authors, is confusing and palpably untenable for two reasons. *First*, the fora for adjudication of an application under Section 8 of the Act and Section 11 of the Act are different, and *second,* an application under Section 8 of the Act is kept in abeyance pending adjudication of an application under Section 7 of the Code and may get ultimately dismissed as infructuous without examination on its merits in the event insolvency application is admitted. Further, if the cases above are to be followed, an application under Section 11 of the Act would not be adjudicated upon or simply dismissed if an application under Section 8 of the Act is dismissed. This would be contrary to the position of law that any proceedings for its benefit can be pursued by the corporate debtor even during moratorium.

Therefore, there would be a larger legal risk in treating an application under Section 8 of the Act as a precedent for deciding an application under Section 11 of the Act, more so as the dismissal of the former is not based on merits. Such a proposition also ignores the doctrine of party autonomy and goes against the law laid down by several landmark judgments of the Supreme Court.[20]

5. CONCLUSION

The article discusses the interplay of arbitration and insolvency laws. The article critiques *Indus Biotech* from a practical perspective and takes into account ground realities of what is and might happen in a situation where the Adjudicating Authority is faced with the above permutation and combination of situation. Accordingly, the article suggests employing the test of "dressed up petition" at the pre-admission stage to separate wheat from chaff and allow only such cases to undergo CIRP where it is not for the ulterior purposes, other than resolution.

While the need for an established insolvency law and mechanism cannot be understated, the supremacy granted *vide* Section 238 of the Code must not be misconstrued. The Adjudicating authority must acknowledge, while admitting an application under Section 7 of the Code, that such an application is genuinely for the resolution of the corporate debtor and not for some ulterior or *mala fide* purposes, dressed up in a manner to avoid arbitration agreement under the garb of exercising statutory right. Further, the adjudication of counter-claims can be done appropriately by an arbitral

20. *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.

tribunal, as the Adjudicating Authority need not adjudicate upon a dispute between the parties, and ought to admit the corporate debtor into insolvency upon merely finding the existence of a default. Therefore, in order to effectively create a system that curbs spurious insolvency applications, it would be extremely important that an application under Section 11 of the Act is not dismissed basis prior dismissal of an application under Section 8 of the Act, happening of which may also impact the overall scheme of the Code to maximise the value of corporate debtor.

The above article, therefore, urges the courts, especially the Adjudicating Authority, to keep in mind the holding of the Supreme Court in the case of *Vidarbha Industries*, and give due regard to 'disputed' defaults before admitting an application under Section 7 of the Code. In doing so, the Adjudicating Authority, in no manner, would be relegating its statutory functions as entrusted with it under the Code.