DISCRETION IN ADMISSION OF APPLICATION UNDER §7 OF THE INSOLVENCY & BANKRUPTCY CODE, 2016: A WIN FOR ARBITRATION

*Meenal Garg & Krish Kalra**

The current jurisprudence regarding the interplay between§7 of the Insolvency and Bankruptcy Code, 2016 ('IBC') and arbitration stands in favour of the former in light of the Supreme Court's decision in Indus Biotechv. Kotak India Venture (Offshore) Fund ('Indus Biotech'). However, the recent pronouncement of the Supreme Court in Vidarbha Industries Power Ltd. v. Axis Bank Ltd. ('Vidarbha') has added an element of discretion between determination of default and admission of an application under §7 of the IBC. Interestingly, the effect of Vidarbha on the jurisprudence as established by Indus Biotech has not been examined and decided by any court of law in India till date. Therefore, this paper has been written from a practitioner's perspective and aims to address this research gap by examining the impact of Vidarbha Industries on Indus Biotech. This paper does not critique the judgment in Vidarbha and primarily aims to explore the element of discretion whilst adjudicating upon a §8 application under the Arbitration Act, 1996. In essence, this paper analyses the potential impact of the ratio laid down in Vidarbha to the existing interplay between insolvency law and arbitration in India assuming that the discretion by the Adjudicating Authority is exercised in a reasonable manner. This part also analyses and aims to provide certain guiding principles whilst exercising discretion under §7 of the IBC particularly in context of arbitration. Moreover, this paper also opines that the Resolution Professional ('RP') would not be inclined to initiate any arbitration proceedings on behalf of the corporate debtor because of the strict timelines under the IBC. Finally, this paper concludes that though it is not mandatory for the Adjudicating Authority to refer all insolvency applications to arbitration, a harmonious reading of Indian insolvency law and arbitration law in light of the Vidarbha ruling should ordinarily persuade the tribunal to refer disputes to arbitration.

* Meenal Garg is an Associate at Khaitan and Khaitan, New Delhi and Krish Kalra is an Associate at K.N. Legal, New Delhi.

Table of Contents

I. INTRODUCTION

The Insolvency and Bankruptcy Code, 2016 ('IBC') provides for the insolvency proceedings of a corporate debtor on an application by a financial creditor, operational creditor or the corporate debtor itself under §7[1], §9[2] and §10[3] of the IBC respectively,provided there is a default on a debt exceeding one crore rupees.[4] As per §3(8) of the IBC, a corporate debtor is a corporate person or a company who owes any debt to a person.[5] §5(7) of the IBC defines a financial creditor as a person to whom a financial debt is owed.[6] Furthermore, §5(8) of the IBC provides that a financial debt is a debt essentially disbursed against the time value of money.[7] §5(20) of the IBC defines operational creditor as a person to whom an operational debt is owed.[8] Furthermore, §5(21) of the IBC defines operational debt to mean debt in respect of provision of goods or services i.e. debt disbursed during the course of ordinary business dealings.[9]

§7 of the IBC provides for admission of an application for insolvency wherein there is a default in payment of the financial debt payable to a financial creditor by the corporate debtor.[10] Until recently, this provision has been interpreted to mean that in cases where a default is established, there would be an automatic admission of the corporate debtor to the insolvency process. However, the Supreme Court's recent decision in *Vidarbha Industries Power Ltd.* v. *Axis Bank Ltd.* ('Vidarbha'), wherein it has been held that the Adjudicating Authority ('AA') has a discretion in the admission of a §7 application under the IBC, has created a discourse amongst the academia and the practitioners alike.[11] On the other hand,

1 The Insolvency and Bankruptcy Code, 2016, §7.
2 *Id*., §9.
3 *Id*., §10.
4 *Id*., §4.
5 *Id*., §3(8).
6 *Id*., §5(7).
7 *Id*., §5(8).
8 *Id*., §5(20).
9 *Id*., §5(21).
10 *Id*., §7.
11 Vidarbha Industries Power Ltd. v. Axis Bank Ltd., (2022) 8 SCC 352, ¶77, ¶79.

one aspect of this ruling that the practitioners seemed to have overlooked is the effect of Vidarbha on arbitration in India.

It is pertinent at this juncture to mention that prior to Vidarbha, the Supreme Court in *Indus Biotech (P) Ltd.* v. *Kotak India Venture (Offshore) Fund* ('Indus Biotech'), had held that while considering a §7 application under the IBC, the AA is only required to determine the existence of a debt and its "default" under the IBC and it is only in the absence of the same, that an application for reference to arbitration entertained by the AA.[12] Thus, the logical consequence of Indus Biotech is that despite the existence of an arbitration clause, the AA shall admit an application under §7 of the IBC if a "default" is made out from the records produced before it.

In the light of the above, this paper proposes that pursuant to the Apex Court's ruling in Vidarbha, there is a greater discretion with the AA to refer the disputes to arbitration and that the AA would be generally inclined toward sreferring most disputes to arbitration. Furthermore, it has also been opined that since insolvency proceedings can have an adverse impact on the goodwill and financial well-being of an entity, the AA would usually lean in the favour of referring a dispute to arbitration as against admitting the insolvency proceedings,atleast until it has cogent reasons not to do so.

Furthermore, this paper does not embark on a comprehensive critique of the Vidarbha ruling on the IBC in general as the same would lie outside the ambit of this paper. The present paper is limited to applying the element of discretion to resolve the conflict between the insolvency and arbitration law. Such a critique has not been undertaken since the review petition against the Vidarbha has also been dismissed by the Supreme Court in *Axis Bank Ltd.* v. *Vidarbha Industries Power Ltd*.[13]

To substantiate the above-mentioned points,this paper adopts a doctrinal approach to examine the relationship between §7 and arbitration from a practitioner's perspective. As such, this paper is divided into five parts; Part II of this paper examines the interplay between insolvency law and arbitration prior to the Supreme Court's decision in Vidarbha. Part III of this paper examines the ruling of the Supreme Court in Vidarbha. Part IV of this paper examines the potential impact of the *ratio* laid down in Vidarbha to the existing relationship between insolvency law and arbitration in India. This part further opines that in light of the principles pertaining to §8 of the Arbitration and Conciliation Act, 1996 ('Arbitration Act'), the AA would generally be inclined to refer the disputes to arbitration.[14] Part V concludes, observing that pursuant to the Apex Court's ruling

[12] Indus Biotech (P) Ltd. v. Kotak India Venture (Offshore) Fund, (2021) 6 SCC 436, ¶29.
[13] Axis Bank Ltd. v. Vidarbha Industries Power Ltd., (2023) 7 SCC 321.
[14] The Arbitration and Conciliation Act, 1996, §8.

in Vidarbha, the AA can exercise greater discretion to refer the disputes between the parties to arbitration in an application under §7 of the IBC.

Before, proceeding with this analysis, it is imperative to clarify that this paper does not examine in detail the relationship between §9 of the IBC and arbitration. This is because §9(5)(i)(c) provides that an application for insolvency cannot be admitted where the operational creditor receives notice regarding the existence of the operational debt.[15] Thus, in such circumstances, an arbitration proceeding disputing the very existence of the debt may be allowed by the AA provided there is no controversy surrounding the same. Similarly, there is no scope for arbitration in an application under §10 of the IBC wherein the corporate debtor itself is declaring its insolvency.

II. THE INTERPLAY BETWEEN §7 OF THE IBC AND ARBITRATION PRIOR TO VIDARBHA

This part lays down the relevant provisions of Indian insolvency law and arbitration law to the instant line of inquiry, tracing the current jurisprudence on §7 of the IBC and its consequent impact on the arbitration proceedings between a financial creditor and the corporate debtor.

§7 of the IBC bestows on a financial creditor the right to file for insolvency of a corporate debtor. A combined reading of §5(7) and §5(8) of the IBC reveal that a "financial creditor"is an entity that has lent money to the corporate debtor against the time value of money. Thus, a "financial creditor" would typically include lenders who have advanced loans to finance a business. Moreover, these financial creditors are vested with the right to file an insolvency application under §7 in case of "default" by the corporate debtor. Moreover, as per §3(11) of the IBC a "default" would merely entail non-payment of the whole or the part of the debt.[16]

To explain the interplay between §7 of the IBC and arbitration, one is compelled to take a hypothetical example as no convergent issue has come up before the Indian courts as of yet. In the said hypothetical example, it is assumed that a financial creditor has advanced money to a corporate debtor, the former now alleging that the said debt has not been paid up by the stipulated date. The financial creditor may allege that the corporate debtor has defaulted, to which, the corporate debtor may refute its liability by disputing the existence of a default in the first place or as to the quantum of default. It is also probable that the financing agreement between the two parties contains an arbitration clause and, as such, either of the parties may desire that the dispute be referred to arbitration as per the terms of the arbitration clause. However, bypassing the stipulations of the arbitration

[15] The Insolvency and Bankruptcy Code, 2016, §9(5)(i)(c).
[16] *Id*., §3(11).

agreement, the financial creditor could opt for filing of an insolvency application under §7 of the IBC. It is on the filing of such an application that the inherent conflict between insolvency law and arbitration law comes into the picture.

Before we examine the relationship between insolvency law and arbitration, a short detour into the relevant provisions of Indian arbitration law is appropriate. Arbitration law in India is governed by the Arbitration Act, §8 of which provides that a judicial authority necessarily needs to refer the parties to arbitration where an application under the same is filed in any proceeding qua the disputes in respect of which there exists an arbitration clause. Similarly, §11 of the Arbitration Act provides that where the parties are unable to agree to the appointment of an arbitrator or are unable to adhere to the procedure for appointment of an arbitrator, the relevant court, may appoint an arbitrator for the parties.[17]

It is also pertinent to examine the effect of §14 of the IBC to effectively examine the interplay between insolvency and arbitration law.[18] §14(1)(a) prohibits institution and continuation of any proceedings against the corporate debtor once the insolvency petition has been admitted.[19] On the other hand, as per §25(2)(b) of the IBC, only the resolution professional ('RP') has discretion to allow the continuance of any proceedings on behalf of the corporate debtor including arbitration proceedings.[20] In our opinion, this scheme is to prevent multiple legal proceedings against a financially distressed company and to provide for a centralized forum wherein all the claims of the creditors can be admitted.[21] On the other hand, the RP has been vested with the discretion to allow the continuance of any proceedings on behalf of the corporate debtor to provide for the RP to apply its best judgment in realizing maximum assets to satisfy the claims of the creditors.[22]

With this backdrop, one may return to the example at hand. After the filing of a §7 application under the IBC, the corporate debtor may prefer an application under §8 of the Arbitration Act before the AA for the referral of the disputes to arbitration pursuant to the arbitration clause provided in the financing agreement between the parties. It is here that the AA is faced with the question of whether to proceed with the insolvency proceedings or refer the disputes for arbitration. An additional complication that may arise in this scenario is that the corporate debtor may in parallel to the insolvency proceedings also prefer an application under §11 of the Arbitration Act. Now, in these circumstances, the court dealing with the §11 application would also have to consider the effect of the pendency of insolvency proceedings before deciding the said §11 application. These

---

17 The Arbitration and Conciliation Act, 1996,§11.

18 The Insolvency and Bankruptcy Code, 2016, §14.

19 *Id*., §14(1)(a).

20 *Id*., §25(2)(b).

21 P. Mohanraj v. Shah Bros. Ispat (P) Ltd., (2021) 6 SCC 258, ¶¶29-31; Dena Bank v. C. Shivakumar Reddy, (2021) 10 SCC 330, ¶68; RKKR Steels (P) Ltd. v. Ramakrishnan Sadasivan, Company Appeal (AT) (Insolvency) No. 473 of 2020 (NCLAT Chennai Bench) (Unreported), ¶7.

22 Power Grid Corpn. of India Ltd. v. Jyoti Structures Ltd., 2017 SCC OnLine Del 12189, ¶¶10-12.

are precisely the questions that were raised and have been answered by the Apex Court in Indus Biotech.

In the said case, a §11 application under the Arbitration Act had been preferred by the Applicant in furtherance of the arbitration clause between the parties. One of the questions before the Court pertained to the priority *inter se* of the determination of default and arbitral reference under §8 of the Arbitration Act. This is because if a §7 application is entertained and admitted, then the arbitration proceedings cannot proceed owing to the moratorium imposed on all proceedings against the corporate debtor under §14 of the IBC, which would also suspend the arbitration proceedings. On the other hand, if a §8 application under the Arbitration Act is allowed and the parties are referred to arbitration thereunder, then the insolvency proceedings would stand adjourned till the pendency of the arbitration proceedings. It is relevant to note here that the Supreme Court has opined in Vidarbha that the AA exercising discretion, may either keep the main application under §7 in abeyance or even reject such application on considering a host of relevant factors. This is because a financial creditor is not deprived of their right to file a fresh application in case the financial health of the corporate debtor further deteriorates.[23] Hence, in our opinion it is only after the culmination of the arbitration proceedings that the Court would be able to decipher the existence any default for admitting of an application under §7 of the IBC.

However, the Apex court in Indus Biotech resolved this conundrum by making a reference to §238 of the IBC, averring that the IBC shall prevail over all other statutory enactments including the Arbitration Act.[24] The Court held that even where a §8 application under the Arbitration Act is filed, the AA is first required to determine the existence of a default under §7, only in the absence of which can a§8 application under the Arbitration Act be examined.[25] After the said ruling, the court opined that the quantum of default was not conclusively ascertainable from the material available on record and that said quantum of default could only be determined after the adjudication of disputes between the parties through arbitration.[26] Consequently, the court constituted an arbitral tribunal.[27] Interestingly, the Supreme Court in Vidarbha did not consider the effect of §238 since the question of repugnancy between two statutes did not arise.

It is evident that in the Indus Biotech case, the Court has created a new category of cases that can be termed as dubious 'default' cases wherein if the quantum of default cannot be ascertained, the parties are to be referred to arbitration. It is pertinent to mention that various methodologies are,in fact, available to the financial creditor and the corporate debtor to quantify the amount of default.

---

23 Vidarbha Industries Power Ltd. v. Axis Bank Ltd., (2022) 8 SCC 352, ¶79.
24 Indus Biotech (P) Ltd. v. Kotak India Venture (Offshore) Fund, (2021) 6 SCC 436, ¶27.
25 *Id*., ¶¶27-29.
26 *Id*., ¶¶33-35.
27 *Id*., ¶39.

However, in such a scenario, the AA would have to consider a number of factors such as likelihood of success and conduct of parties, among many others, to ascertain whether a case constitutes dubious default or not.

In the aftermath of Indus Biotech, tribunals across the country have proceeded to first examine the existence of default and only when a default is not made out have the parties been referred to arbitration.[28]

One argument that may be employed by the financial creditor to rebut arguments regarding applicability of arbitration law principles to instant scenario is that as per the scheme of §238 of the IBC, the principles of insolvency prevail over the principles of arbitration. However, the said provision only operates when there is inconsistency or repugnancy with another Act. In Indus Biotech it was held that, to resolve this discrepancy, the AA would first be required to determine the default instead of referring the matter to arbitration under §8 of the Arbitration Act.[29] On the other hand, as argued herein, even once the default has been determined, the AA must exercise discretion in a reasonable manner in referring the disputes to arbitration, wherever necessary, instead of admitting the §7 application under the IBC. In other words, it has been argued that there is no repugnancy with the IBC at the discretionary stage that calls for application of §238 and hence, the said argument fails on this point alone.

The High Courts have taken a cue from the Supreme Court and have restricted themselves to adjudging the existence of an arbitration clause and disputes between the parties pertaining to §11 applications under the Arbitration Act. In this regard, the Delhi High Court has opined in *Millennium Education Foundation* v. *Educomp Infrastructure and School Management Ltd.* that the pendency of an insolvency proceedings is irrelevant for adjudicating an application under§11 of the Arbitration Act.[30] This is because even if the said proceedings are admitted, the same would result in a moratorium under §14 of the IBC, which would stay the arbitration proceedings.[31] A similar view has been taken by the Bombay High Court in *Jasani Realty (P) Ltd.* v. *Vijay Corpn*.[32] This implies that as long as a §7 application under the IBC is not admitted, the arbitration proceedings and the insolvency proceedings can progress simultaneously.

From the aforesaid jurisprudence, it is further evident that,thus far, the AAs have proceeded to first examine the existence of default under §7 of the

[28] *See* Urban Infrastructure Trustees Ltd. v. Ozone Propex(P)Ltd., 2020 SCC OnLine NCLT 6288 (NCLT Bengaluru Bench) (Unreported), ¶¶19-21; *See also* Urban Infrastructure Trustees Limited v. Ozone Propex (P)Limited, W.A. 3833 of 2019, Order dated February 10, 2022 (Kar. H.C.) (Unreported), ¶¶34-36.

[29] Indus Biotech (P) Ltd. v. Kotak India Venture (Offshore) Fund, (2021) 6 SCC 436, ¶27.

[30] Millennium Education Foundation v. Educomp Infrastructure & School Management Ltd., 2022 SCC OnLine Del 1442, ¶18.

[31] Millennium Education Foundation v. Educomp Infrastructure and School Management Ltd., 2022 SCC OnLine Del 1442, ¶¶16-18.

[32] Jasani Realty (P) Ltd. v. Vijay Corpn., 2022 SCC OnLine Bom 879, ¶¶21-22.

IBC and only in the absence of which or in a case of dubious default can the parties be referred to arbitration. On the other hand, the High Courts have disregarded the pendency of an insolvency petition while deciding a §11 application under the Arbitration Act.[33] We infer that this is primarily due to two reasons. *First*, until the insolvency proceedings are admitted, they are considered as proceedings in *personam* and it is only after the admission of insolvency proceedings that the insolvency proceedings take on the character of proceedings in *rem* and are consequently not arbitrable.[34] It is pertinent to mention that proceedings *in personam* refers to proceedings against a specific entity whereas proceedings *in rem* refer to proceedings against the world at large. In the present context, an *in personam* dispute would mean a dispute between the financial creditor and the corporate debt. After the admission of an insolvency application, the insolvency proceedings become a proceeding *in rem*, that is, when claims are invited from all prospective creditors against the insolvent corporate debtor. *Second*, even if the arbitration proceedings are allowed to commence between the parties, any consequent admission of insolvency proceedings would trigger an automatic moratorium under §14 of the IBC, staying any and all arbitration proceedings against the corporate debtor.[35] We must note that under the IBC, the RP has discretion to initiate or continue any pending arbitration proceedings instituted by the corporate debtor, an aspect that is discussed in Part IV of this paper.

Thus, it appears that contemporary jurisprudence stands in favour of insolvency law wherein the admission of a §7 application under the IBC would override any ongoing arbitration proceedings against the corporate debtor. Furthermore, a corporate debtor's application under §8 of the Arbitration Act for referring the *in personam* dispute regarding the debt in question to arbitration would not survive the admission of a §7 application under the IBC. The following section analyses in detail the precedent laid down in Vidarbha.

III. ELEMENT OF DISCRETION: THE RATIO IN VIDHARBHA

The present part of the paper examines the Supreme Court's decision in Vidarbha. Although the said decision was not in context of arbitration law,we argue that its *ratio* can be applied to the existing jurisprudence concerning the interplay between insolvency law and arbitration. We argue that though the contours of discretion in the admission of insolvency petitions is yet to be tested by Indian courts, considering the pro-arbitration stance taken by Indian courts and the fact that only distressed companies are to be admitted to insolvency, the AA should ordinarily discretion to refer the disputes to arbitration. It is pertinent to mention

[33] *See* Millennium Education Foundation v. Educomp Infrastructure and School Management Ltd., 2022 SCC OnLine Del 1442, ¶¶16-18; Jasani Realty (P) Ltd. v. Vijay Corpn.,2022 SCC OnLine Bom 879, ¶¶21-22.

[34] Indus Biotech (P) Ltd. v. Kotak India Venture (Offshore) Fund, (2021) 6 SCC 436, ¶¶21-22.

[35] *See* Lanco Infratech Ltd.v. Isolloyd Engg.Technologies Ltd., 2017 SCC OnLine NCLT 12502, ¶8.

here that even before the decision in Vidarbha, there have been certain instances wherein arguments have been mounted by the corporate debtor alleging that the power to admit a §7 application under the IBC is discretionary.[36] However, there has been no precedent regarding the same prior to Vidarbha.

In the present case, the Appellant operated an electricity generation plant.[37] Pursuant to an arbitration, it obtained an award of Rs. 1,730 crores against the Maharashtra Electricity Regulatory Commission ('MERC') in its favour but the same could not be realized due to pendency of an appeal preferred by MERC.[38] During the pendency of the appeal, the Respondent bank preferred an application under §7 of the IBC claiming a default of approximately Rs. 553 crores.[39] It is pertinent to mention here that MERC was not a party to the insolvency proceedings as the same is a proceeding between the corporate debtor and the financial creditor. On the strength of its award, the Appellant filed a stay application before the AA for stay of insolvency proceedings. The said application was dismissed by the AA and further by the NCLAT on appeal.[40] Consequently, the question arose before the Apex Court as to whether it is mandatory to admit an application under §7 of the IBC once a default is made out despite the existence of an award in the favour of the Appellant.

The Court answered the above question in the negative. The Court first went on to examine the objectives of the IBC and opined that it was enacted for the expedient resolution of corporate entities that are in "the red" i.e. have an overall poor financial health.[41] Next, the Court interpreted the language of §7(5)(a)[42] of the IBC to entail that the existence of a default only confers upon the financial creditor a right to apply for insolvency proceedings and the AA must apply its mind in before initiating insolvency proceedings.[43] In this regard, the Court held that the legislature has consciously used the word "may" to mean that mere existence of debt and default only vests the financial creditor with a right to apply for the initiation of insolvency proceedings and that the AA is required to exercise its mind whilst deciding whether to admit or reject the insolvency application.[44] The Court also compared the language of §7(5)(a) and §9(5)(a)[45] of the IBC, and opined that the legislature has consciously used the word "may" in the former and the word "shall" in the latter, given that the language of the two provisions is almost identical otherwise. Consequently, the Court opined that this conscious difference in the drafting of the two provisions is proof of the fact that the AA has

[36] *See* Yes Bank Ltd. v. Jaypee Healthcare Ltd., CP (IB) 512 of 2019 (NCLT Allahabad Bench) (Unreported), ¶19.
[37] Vidarbha Industries Power Ltd. v. Axis Bank Ltd., (2022) 8 SCC 352, ¶2.
[38] *Id*., ¶¶14-16.
[39] *Id*., ¶18, ¶52.
[40] *Id*., ¶¶19-22.
[41] *Id*., ¶45, ¶60.
[42] The Insolvency and Bankruptcy Code, 2016, §7(5)(a).
[43] Vidarbha Industries Power Ltd. v. Axis Bank Ltd., (2022) 8 SCC 352, ¶62.
[44] *Id*., ¶¶61-62.
[45] The Insolvency and Bankruptcy Code, 2016, §9(5)(a).

discretion in the admission of an application under §7.[46] Thus, the Court concluded that the use of the word "may" in §7(5)(a) allows the AA to exercise its discretion in admitting insolvency applications, provided the said discretion is exercised in a reasonable manner.[47]

The Court also noted that the objective of the IBC is not to penalize an entity for having failed to pay its financial debt for a short period of time.[48] Such an observation indicates that even in the absence of a legally tenable defence for non-payment of financial debt, a Corporate Debtor may still be excused for non-payment of dues if the same is for a short period of time for a reason beyond its control. To illustrate the above contention, we take the example of the COVID-19 pandemic. It is common knowledge that many entities that faced significant losses on account of the pandemic were otherwise profitable or sound. Although, the IBC provided a one-year respite in respect of defaults incurred on account of COVID-19, many business houses have taken considerable time to fully recover from the COVID-19.[49] Therefore, in such circumstances, the Court may excuse the non-payment of financial debt on account of COVID-19 and exercise discretion in refusing to admit insolvency proceedings. We must note here that the considered scenario is hypothetical and there isn't any reported case where the AA has excused the corporate debtor from non-payment when such failure to pay was caused by factors beyond its control.

In Vidarbha, the Court has further attempted to balance the twin objectives of time bound insolvency proceedings and the need that corporate debtors should not be unnecessarily dragged into insolvency. To that end, the court has emphasised that the first essential fact to be determined is whether the corporate debtor is, in fact, on the verge of insolvency or bankruptcy.[50] This is because a time bound resolution process is only requisite in respect of distressed corporate debtors and not in respect of every corporate debtor against whom an insolvency application has been filed levelled. Furthermore, the Court also reasoned that this is precisely why there is no rigid timeline for admitting a §7 application under the IBC.[51] The Court also opined that an exercise discretion by the AA would not affect the rights of the financial creditor, who can always prefer another application to initiate insolvency proceedings.[52] In other words, a financial creditor's right to initiate insolvency proceedings against a corporate debtor is not defeated or extinguished once discretion is exercised by the AA.

Finally, the Court whilst applying the aforesaid reasoning held that the fact of there being an award in favour of the corporate debtor capable of

[46] Vidarbha Industries Power Ltd. v. Axis Bank Ltd., (2022) 8 SCC 352,¶76.
[47] *Id*., ¶63, ¶¶76-77.
[48] *Id*., ¶82.
[49] *See* The Insolvency and Bankruptcy Code, 2016, §10A.
[50] Vidarbha Industries Power Ltd. v. Axis Bank Ltd., (2022) 8 SCC 352, ¶83.
[51] *Id*., ¶86.
[52] *Id*., ¶79.

satisfying the entire default, as alleged by the Respondent, is certainly a relevant fact for the exercise of discretion by the AA.[53] As such, it remanded back the matter to the AA for fresh determination in light of its observations.[54]

Given that the decision in Vidarbha was not made in the of context of arbitration, the judgement has omitted to discuss the Indus Biotech ruling. However, a harmonious reading of the two judgments would reveal that Vidarbha has added a discretionary stage subsequent to the identification of a default and preceding the admission of a §7 application under the IBC. The above analysis has revealed that mere existence of default is not the threshold for admission of the insolvency proceedings but only gives rise to a right to apply for insolvency proceedings in favour of the financial creditor. Thereafter, it is upon the discretion of the AA to admit the §7 application under the IBC. Although, the contours of this discretion would be clarified in due course, it is reasonable to assume that the onus would be upon the corporate debtor to establish the requisite circumstances for exercising such discretion.

The next section sheds light upon the stage of discretion and how the same can culminate in the acceptance of a §8 application under the Arbitration Act, even in cases where a "default" has been made out against the corporate debtor.

IV. IMPACT OF VIDHARBHA ON INSOLVENCY AND ARBITRATION

This part of the paper examines how the ruling in Vidarbha can affect the status quo of the interplay between insolvency law and arbitration. To that end, three aspects are considered; the manner of exercise of discretion by the AA, the inexpedient right of RP to institute or continue arbitration proceedings and the pro-arbitration stand of Indian courts.

A. EXERCISE OF DISCRETION

To examine the discretionary prerogative of the AA, we may return to the example at hand wherein the financial creditor files an application under §7 of the IBC and the corporate debtor files an application under §8 of the Arbitration Act before the AA.

When a default is made out by the financial creditor for the admission of a §7 application under the IBC, The onus would be on the corporate debtor to demonstrate the existence of such circumstances so as to compel the AA to exercise discretion and refuse to initiate insolvency proceedings.

[53] *Id*., ¶90.
[54] *Id*., ¶91.

Although the contours and manner of exercise of discretion by the AA are yet to be tested by the Indian courts, it is safe to say that such a discretionary exercise would depend on the facts and circumstances of each case. In the context of arbitration, we opine that practically, the AA would have to take into account the effect of the potential award, the likelihood of succeeding in arbitration and the quantum of award, among other factors, in exercising its discretionary prerogative. For instance, an arbitral proceeding may result in an award which is sufficient to satisfy the entire purported debt of the financial creditor. It is also possible, after crystallization of debt through arbitration, the quantum of default may be much lower than previously claimed by the financial creditor and the corporate debtor may have requisite assets to satisfy such debt. In fact, the Supreme Court in Indus Biotech had hinted that the arbitration process should not be used as means of derailing insolvency proceedings.[55]

The manner of such exercise is slowly becoming concrete as more and more cases are being adjudicated by the AA. For instance, in the recent case of *Canara Bank* v. *GTL Infrastructure Ltd.*, the NCLT Mumbai dismissed an application under §7 despite determining a default by applying the ratio in Vidarbha.[56] In the said case, the default amount was approximately Rs. 646 crores.[57] However, the court noted that firstly, the corporate debtor had a monthly revenue of Rs. 120 crores. Furthermore, the corporate debtor had paid an amount of Rs. 16,915 crores between 2011 and 2018. Next, the corporate debtor had claims aggregating to Rs. 13,393 crores against third party entities out of which it had already been awarded Rs. 900 crores which was pending in appeal. Lastly, the corporate debtor also had claims aggregating to Rs. 420 crores against other entities.[58] Based on these facts, the AA held that the adjudicated and unadjudicated claims of the corporate debtor were far higher than the default of the financial creditor and, as such, the corporate debtor was a financially viable and sustainable going concern which need not be admitted into Corporate Insolvency Resolution Process ('CIRP').[59]

At this juncture, one may also pose a question as to why the quantum of default is relevant to the admission or non-admission of an insolvency application once a default has been made out. This question becomes all the more pertinent in light of the Supreme Court's ruling in *Innoventive Industries Ltd.* v. *ICICI Bank*[60], wherein it has been held that the quantum of default is irrelevant for the AA and all that is required to that the threshold requirement under §4 of the IBC is satisfied.[61] The answer to this question is that although the quantum of default may be irrelevant for determining debt and default, a crystallized debt would have to be compared with the assets of the corporate debtor to ascertain if the corporate

[55] Indus Biotech (P) Ltd. v. Kotak India Venture (Offshore) Fund, (2021) 6 SCC 436, ¶27.
[56] Canara Bank v. GTL Infrastructure Ltd., C.P. (IB) No. 4541 of 2019 (NCLT Mumbai) (Unreported).
[57] *Id*., ¶1.
[58] *Id*., ¶11.
[59] *Id*.
[60] Innoventive Industries Ltd. v. ICICI Bank, (2018) 1 SCC 407.
[61] *Id*., ¶¶29-30.

debtor warrants insolvency or not. In other words, the quantum of default would be relevant for the exercise of discretion by the AAs and not for determining existence of default. To illustrate, suppose in an application filed by the financial creditor wherein a default has been made out and the only fact in dispute is the quantum of default. As per the financial debtor, the debt due is Rs. 5000 crores whereas as per the corporate debtor, the debt due is Rs. 500 crores. Furthermore, the assets of the corporate debtor are to the tune of Rs. 1500 crores and there is no other creditor of the corporate debtor. Now, till the time this dispute is not resolved, it cannot be ascertained whether the corporate debtor is a financially distressed company or not, as the corporate debtor has sufficient assets to meet its liability of Rs. 500 crores but not nearly enough assets to meet its liability of Rs. 5000 crores. Thus, in such cases, the insolvency proceedings would have to be kept on hold till the time the debt due is crystallized by way of arbitration.

As a consequence, the corporate debtor may plausibly contend that disputes with regards to the existence of default or the quantum of default itself ought to be referred to arbitration and cannot be adjudicated by the AA. As stated earlier, a crystallized quantum of default would be relevant to the AA in determining if the corporate debtor has sufficient assets to satisfy the alleged debt. Hence, it is argued that the AA should ordinarily await the outcome of the arbitration proceedings in the interest of determining the quantum of default and assessing the financial condition of the corporate debtor.

B. INEXPEDIENT RIGHT OF RP TO INITIATE OR CONTINUE ARBITRATION PROCEEDINGS

At this juncture, an aspect that merits discussion is the RP'svested right to continue or initiate arbitration proceedings. §25(2)(b) of the IBC empowers the RP to act on behalf of the corporate debtor for their benefit in an arbitration proceeding.[62] Thus, the financial creditor may argue that the AA can simply proceed with the admission of §7 application under the IBC and leave it the RP to, it their discretion, initiate or continue to participate in any ongoing arbitration proceedings. At the outset, this argument sounds plausible, but it is argued here that the same cannot be a basis for refusal to exercise discretion by the AA.

We must note that the RP is an officer of the court and is thereby bound by the timeline contemplated under the IBC.[63] In this respect, §12(1) of the IBC provides that the insolvency process shall be completed within a period of 180 days from the date of admission of the insolvency application.[64] Furthermore, §12(2) and §12(3) provide that the AA ac extend this timeline by a maximum

[62] The Insolvency and Bankruptcy Code, 2016, §25(2)(b).

[63] *See also* Meenal Garg, *The Curious Case of Resolution Professional as an Officer of the Court*, Vol. 9(1),RGNUL Fin. & Mercantile L. Rev., 51 (2022).

[64] The Insolvency and Bankruptcy Code, 2016, §12(1).

period of 90 days.[65] Lastly, the proviso to §12(3) defines the upper limit for completion of the CIRP as within 330 days.[66] Thus, the RP is bound to complete the insolvency process within a maximum period of 330 days or eleven months. In contrast, §23(4) of the Arbitration Act provides for a period of six months for the completion of pleadings and §29A(1) of the Arbitration Act provides for a period of twelve months for completion of the entire arbitration proceedings from the date of completion of such pleadings.[67] Thus, logically, an innertime limit of eighteen months has been provided by the Arbitration Act which can be extended by another six months by the parties under §29A(3) of the Arbitration Act and can be further extended by the court under §29A(4) of the Arbitration Act as may be required.[68]

From a bare perusal and comparison of the timelines under the IBC and the Arbitration Act, it is evident that even bona fide arbitration proceedings can take up to eighteen months to result in an award whereas the RP is required to complete the insolvency process within 330 days or eleven months. Thus, it is unlikely that the arbitration proceedings can be completed within the stipulated timelines under the IBC. Furthermore, there is an added issue of delay in realization of the award amount as was noticed in the case of Vidarbha. Thus, it is highly unlikely that the RP would exercise its right to initiate or continue arbitration proceedings even if the same may ultimately lead to realization of additional amounts in favour of the corporate debtor as the same cannot be completed within the timeline stipulated under the IBC. Moreover, the RP would rather be inclined to abandon the arbitration proceedings to save legal costs. However, the said inference is based on the practical experience of the authors and no case law or empirical study exists that would confirm how frequently RP exercises its power to continue an arbitral proceeding.

Another rationale meriting the non-exercise of powers by the RP has been noted by the Supreme Court in *NDMC* v. *Minosha India Ltd*.[69] In this case, the court has noted that after admission of an insolvency application, the management of a corporate debtor goes through a turbulent change. This is because after admission of insolvency application, the board of directors are replaced by the Interim Resolution Professional who is then either confirmed or replaced with the RP by the Committee of Creditors. After a successful resolution plan is approved, a new management takes over the corporate debtor. Thus, with every change in the management of the RP, a new stakeholder comes into picture who may differ on the issue of continuation of arbitration proceedings, hence, the RP would not be in a position to exercise their powers under the IBC in such a scenario.

---

65 *Id*., §§12(2)-12(3).

66 *Id*.

67 The Arbitration & Conciliation Act, 1996, §§23(4)-29A(1).

68 *Id*., §§29A(3)-29A(4).

69 (2022) 8 SCC 384; *See also*, Vidarbha Industries Power Ltd. v. Axis Bank Ltd., (2022) 8 SCC 352, ¶28.

Thus, it can be easily inferred here that the RP's power to initiate or continue arbitration proceedings is neither a viable alternative nor a plausible argument in favour of the financial creditor, given the RP would likely almost never be in a position to exercise its powers. As such, it would be preferable if such factors are to be taken into account by the AA during the pre-admission stage itself wherein strict timelines are absent under the IBC.

C. PRO-ARBITRATION STAND OF INDIAN COURTS

Additionally, one aspect which requires much consideration are the principles governing the admission or rejection of an application under §8 of the Arbitration Act. Interestingly, there has been no precedent that has examined such principles in context of §7 application under the IBC. Perhaps the reason for this is that, thus far, the AAs have conformed to the Indus Biotech position which does not require much consideration of the principles contained in§8 of the Arbitration Act once a default has been established. However, it has been opined that such principles would usually compel the AAs to refer disputes between the financial creditor and the corporate debtor to arbitration especially after the decision in Vidarbha. It is important to clarify that we are not suggesting that the AA should always refer the parties to arbitration, a mandatory reference may unjustly suspend the financial creditor's right to initiate insolvency even when it is abundantly clear that the corporate debtor is a financially distressed entity. As stated earlier, the AA would have to exercise discretion in a reasonable manner and it is only in those cases where it evident that even a favourable arbitral award would not aid the corporate debtor in paying off their debts, should the AA refuse to refer the parties to arbitration.

In this context, the Supreme Court in the landmark case of *P. Anand Gajapathi Raju* v. *P.V.G. Raju*, has laid down the following pre-requisites for referring a dispute to arbitration under §8 of the Arbitration Act:[70]

1. There is an arbitration agreement;

2. The Party to such an agreement brings a dispute against the other party in a court;

3. The subject matter of such a court proceeding is the same as covered under the arbitration agreement; and

4. Such an application is preferred before filing the first statement of defence.

[70] P. Anand Gajapathi Raju v. P.V.G. Raju, (2000) 4 SCC 539, ¶5.

The Court further held that if the aforesaid essentials are satisfied, then it the court will mandatorily refer the parties to arbitration under §8 of the Arbitration Act.[71]

We assert that this mandatory reference to arbitration rule now stands incorporated while adjudicating a §7 application under the IBC in light of the pronouncement in Vidarbha. This is because in Indus Biotech ruling, the AA's examination was limited in scope to only discerning the existence of a default. If a default was established, then the§8 application under the Arbitration Act would fail whereas if no default was established the §7 application under the IBC would fail, leaving no scope to apply the principles enshrined in§8 of the Arbitration Act. However, now with the addition of the element of discretion between the stage of determination of default and the admission of §7 application under the IBC; the AA would be bound to apply the principles pertaining to §8 of the Arbitration Act as explained hereunder.

In the instant example, the AA had determined the default and is now to exercise discretion; therein, amongst the many relevant factors, the pendency of the§8 application under the Arbitration Act preferred by the corporate debtor features prominently. Now, by applying the test stated above, there is an arbitration agreement between the parties pertaining to the subject matter of the insolvency proceedings, namely the default as alleged by the financial creditor who is also a party to the arbitration agreement. It may be assumed that the §8 application under the Arbitration Act was filed by the corporate debtor before filing its reply to the §7 application under the IBC. Hence, the AA would be bound to refer the parties to arbitration, following the law laid down by the Supreme Court as has been discussed. Moreover, the said position will prevail since there is no embargo or guiding principle indicating that the AA should not adhere to the mandatory covenants of the Arbitration Act at the discretionary stage. Moreover, in our opinion, examination of and adherence to the mandatory covenants of arbitration law would have to form part of the AA's reasoning, at least.

Even the Supreme Court in *Vidya Drolia*v. *Durga Trading Corpn*., whilst interpreting the principle of limited judicial interference[72] in arbitration has held that a mere doubt in determining the existence of any of the pre-requisites under §8 of the Arbitration Act, would be sufficient for the court to refer the same to arbitration unless the counter party manages to establish a strong prima facie case to the contrary.[73] The said observations were made by a three judge bench constituted on reference by the two-judge bench as to whether the questions of non-arbitr ability can be decided at the reference stage. It is noted that there is no similar principle in favour of insolvency under the IBC. On the contrary, the Supreme Court's ruling in Indus Biotech in fact establishes that in cases of dubious default,

[71] *Id*., ¶8.
[72] The Arbitration and Conciliation Act, 1996, §5.
[73] Vidya Drolia v. Durga Trading Corpn., (2021) 2 SCC 1, ¶244.

the matter should be referred to arbitration. Hence, even on applying the principle of minimal judicial intervention, the AA would remain ordinarily inclined to refer a dispute to arbitration as opposed to admitting the insolvency application except for cases of malicious arbitration or when it is evident a favourable arbitral award would not, in any case, improve the financial condition of the corporate debtor.

In fact, the AA must also consider the fact that the Supreme Court in *Swiss Ribbons (P) Ltd.* v. *Union of India*, has held that insolvency proceedings are not construed to be in the nature of recovery proceedings.[74] This is because a financial creditor has alternative, efficacious remedies under the Contract Act[75] and the SARFAESI Act[76], among others. Moreover, the objective of initiating insolvency proceedings is to maximize the value of a distressed entity and a hanging sword compelling the corporate debtor to pay their debts. On the other hand, India is striving to be a pro-arbitration state and, as such, in consonance with that objective, it has given statutory backing to the principle of minimal judicial intervention and mandatory reference to arbitration. Thus, a harmonious reading of the two principles would imply that the AA should ordinarily refer the parties to arbitration.

In summary, it can be stated that with the advent of the ruling in Vidarbha, it is relatively likely that the AA is would admit an application under §8 of the Arbitration Act rather than admitting the insolvency proceedings under §7 of the IBC. Moreover, it is evident that this question would have to be necessarily determined by the AA at the pre-admission stage rather leaving the same to the discretion of the RP.

V. CONCLUSION

The discussion has revealed that in practical circumstances, disputes would ultimately be referenced to arbitration under §8 of the Arbitration Act even when there exists a default on the part of the corporate debtor in light of the decision in Vidarbha. Moreover, the mere pendency of a §7 application under the IBC would not hamper the constitution of the arbitral tribunal under §11 of the Arbitration Act, consonant with the position as established in Indus Biotech.

A holistic reading of this paper would reveal that the decision in Vidarbha does not, in fact, contradict the decision of the Supreme Court in Indus Biotech. As a matter of fact, the precedent set out therein merely adds a stage of discretion between the stage of determination of default and admission of an application under §7 of the IBC thus augmenting the interplay between arbitration and insolvency law. However, we must note that the only difference between the

[74] Swiss Ribbons (P) Ltd. v. Union of India, (2019) 4 SCC 17, ¶28.

[75] The Indian Contract Act, 1872.

[76] The Securitisation and Reconstruction of Financial Assets & Enforcement of Security Interest Act, 2002.

two precedents is in how the twin objectives of IBC have been balanced. Whereas Indus Biotech was more inclined towards a time bound and faster resolution of a distressed corporate debtor, Vidarbha has leaned towards the determination of whether the insolvency proceedings are even warranted in the first place, which is also made out from a plain reading of §7 of the IBC.

We have argued that a lack of legislative guidance in exercise of judicial discretion whilst admitting an application under §7 of the IBC and the existence of jurisprudence strongly favouring arbitration in India has led to the inevitable conclusion that the AA would, or rather, should be inclined to refer the parties to arbitration under §8 of the Arbitration Act. In doing so, it may either keep the §7 proceedings under the IBC in abeyance or dismiss the same altogether as suggested by the Supreme Court in Vidarbha.[77]

Lastly, we agree with the observations and the *ratio* laid down in Vidarbha as practically it would discourage the practice of coercing corporate debtors to shell out money under the threat of impending insolvency proceedings. Moreover, the approach adopted in Vidarbha, as discussed in this paper, can go a long away in establishing India as a pro-arbitration jurisdiction. Thus, Vidarbha certainly constitutes a win for arbitration.

[77] Vidarbha Industries Power Ltd. v. Axis Bank Ltd., (2022) 8 SCC 352, ¶80.