

Arbitrability of Insolvency disputes : The Prespective of The Supreme Court of India

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The article provides a summary of the Judgement passed by the Hon'ble Supreme Court of Indian in *Indus Biotech Private limited v. Kotak India venture fund* .² wherein the court has discussed that whether an Application filed under Section 8 of the Arbitration and Conciliation Act , 1996 be maintainable if a petition under Section 7 of the Insolvency and Bankruptcy Code is pending ?

FACTS OF THE CASE :

Kotak India Venture Fund(Financial Creditor) in the year 2007 had subscribed to Optionally Convertible Redeemable Preference Shares (OCRPS) of Indus Biotech Private Limited (Corporate Debtor) . Subsequently, the Corporate Debtor had entered into a share subscription and shareholder agreement (SSSA). According to the regulation 5(2) of the Securities Exchange Board of India (Issue of Capital & Disclosure Requirement) Regulations, 2018 (SEBI ICDR Regulations) the financial creditor chose to convert OCRPS into equity shares to make a Qualified Initial Public Offering (QIPO).

During the process of the above conversion some dispute arose between the creditor and the Corporate Debtor with respect to the calculation and conversion formula to be used for the conversion of OCRPS into equity shares. According to the formula, which was sought to be applied by the Financial Creditor, it would have given them approximately thirty percent of the paid-up share capital of the Corporate Debtor. Whereas, according to the formula which was needed to be applied by the Corporate Debtor aligned with the reports of auditors, independent valuers, and the agreed formula, it would have given the financial creditor ten percent of the total paid share capital of the Corporate Debtor.

While the dispute between the Financial Creditor and Corporate Debtor was ongoing, the Financial Creditor generated the clause of early redemption of OCRPS in the SSSA. When the Corporate Debtor failed to redeem the OCPRPS, the Financial Creditor filed an application under Section 7 of

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² Indus Biotech Private Limited vs Kotak India Venture (Offshore) Fund 2021 SCC OnLine SC 268.

the Insolvency and Bankruptcy Code³ before the NCLT, Mumbai Bench to initiate the corporate insolvency process against the Corporate Debtor.

Consequently, Corporate Debtor invoked the arbitration clause provided in the SSSA and filed an Interlocutory Application before the NCLT under Section 8 of the Arbitration and Conciliation Act, 1996, pleading that the SSSA contains an arbitration clause therefore, the application filed by the Financial Creditor should be dismissed and the parties should be referred to arbitration.

NCLT’S Decision :

The NCLT observed that in a Section 7⁴ petition, there has to be a judicial interpretation as to whether there has been a “default” within the meaning of Section 3(12) of the Insolvency and Bankruptcy Code. It was observed by the NCLT that a default has not occurred in the given case. The Tribunal further distinguished that Corporate Debtor was a solvent, debt-free, and profitable company. Considering that the dispute was purely contractual in nature, the NCLT directed the parties to resolve their dispute by arbitration and dismissed the Insolvency Application.

Aggrieved by the decision of the NCLT, Mumbai Bench, Kotak approached the Supreme Court by filing special leave petition under Article 136 of the Constitution (SLP). Kotak’s primary contention was that the dispute that arose between the parties was a matter in rem and hence cannot be decided through the process of an Arbitration. Indus, on the other hand, argued that the NCLT had adopted the correct approach, and since there was no default present as under the Code, the dispute should be referred to arbitration.

³ The Insolvency and Bankruptcy Code, 2016

⁴ **7. Initiation of corporate insolvency resolution process by financial creditor.**— (1) A financial creditor either by itself or jointly with other financial creditors, or any other person on behalf of the financial creditor, as may be notified by the Central Government, may file an application for initiating corporate insolvency resolution process against a corporate debtor before the adjudicating authority when a default has occurred:

* * *

Explanation.— For the purposes of this sub-section, a default includes a default in respect of a financial debt owed not only to the applicant financial creditor but to any other financial creditor of the corporate debtor.

(emphasis supplied)

Decision of Supreme Court:

The Supreme Court Observed that there are two distinctive features which needs to be decided firstly , the overriding effect of IBC and Secondly arbitrability of insolvency disputes.

Firstly the Supreme Court reaffirmed the position that the IBC shall override all other laws as provided under Section 238⁵ of the IBC which states that “ *Provisions of this Code to override other laws*”. The Supreme Court further added that the above observation is consistent with the rule that when two special laws have provisions repugnant to each other then the statue later in time shall prevail.

Secondly the Apex Court took a refined approach to the question of arbitrability and relied upon the test laid down in *Vidya Drolia & Ors. vs. Durga Trading Corporation*⁶ to hold that an insolvency proceeding becomes in rem only after it is admitted. An admission leads to the creation of a third party right in all the creditors of the corporate debt. Therefore, the Supreme Court observed that the moment an insolvency application is admitted under Section 7 of the Insolvency and Bankruptcy Code , the dispute cannot be settled through arbitration and hence a Section 8 Application would not be maintainable in those circumstances .

In the given case both the Supreme Court and the NCLT observed that there was no ‘default’ in the present case and that the proceedings before the admission of section 7 application are not ‘in rem’ and hence are arbitrable in nature . Hence. The Supreme court upheld the decision of the NCLT and stated that the petition under Section 7 of the Insolvency and Bankruptcy code be dismissed and the petition under Section 8 of the Arbitration and Conciliation Act ,1996 should be allowed.

⁵ Section 238 of the Insolvency and Bankruptcy Code, 2016

⁶ Vidya Drolia v. Durga Trading Corporation, 2019 SCC OnLine SC 358