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### PENDENCY OF CHALLENGE TO AN ARBITRAL AWARD – A BAR TO INSOLVENCY PROCEEDINGS

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The Supreme Court in its recent decision in *K Kishan v M/s Vijay Nirman Company Private Limited*, Civil Appeal No 21825 of 2017, has put to rest the question of whether an arbitral award that has been challenged under Section 34 of the Arbitration and Conciliation Act, 1996 (Act) by the award debtor can form the basis for an action under Section 9 of the Insolvency and Bankruptcy Code, 2016 (Code). The Supreme Court overturned the decision of the National Company Law Appellate Tribunal (NCLAT) and held that the pendency of an application under Section 34 of the Act constitutes a 'dispute' under Section 8 of the Code. Accordingly, the challenge to the arbitral award bars the initiation of the corporate insolvency resolution process (CIRP), under Section 9 of the Code.

#### Background

M/s Vijay Nirman Company Private Limited (Respondent) entered into a contract relating to the construction and widening of a highway with M/s Ksheerabad Constructions Private Limited (KCPL). Certain disputes arose between the parties which were referred to an arbitral tribunal in accordance with the agreement. The arbitral tribunal delivered its award dated 21 January 2017 (Award), wherein certain claims were allowed in favour of the Respondent (Allowed Claims) and KCPL's counterclaims were rejected. On the basis of the adjudication of the debt in the Award, the Respondent issued a notice to KCPL under Section 8 of the Code for payment of the Allowed Claims. KCPL responded within 10 days of receipt of the aforesaid notice, stating that the Allowed Claims are the subject-matter of an arbitration proceeding and the Respondent in fact owes larger amounts to KCPL. KCPL subsequently went on to file a petition under Section 34 of the Act to challenge the Award.

Thereafter, the Respondent initiated CIRP against KCPL by an application under Section 9 of the Code, which was admitted by the National Company Law Tribunal (NCLT) *vide* its order dated 29 August 2017, observing that the pendency of a Section 34 petition was irrelevant considering that there was no stay of the Award by the court. KCPL moved an appeal before NCLAT on the ground that the pendency of a petition under Section 34 of the Act would amount to the 'existence of a dispute' and consequently, the application for initiation of CIRP under the Code is not maintainable. The appeal was dismissed by NCLAT.

At this juncture, after the Appellant appealed against the decision of the NCLAT. The question for consideration before the Supreme Court was whether the Code can be invoked in respect of a claim for operational debt where an application under Section 34 of the Act has been filed against an arbitral award which has been passed in favour of the creditor, when such an application has not been finally adjudicated upon.

## Arguments put Forth by the Parties

The Appellant made two major submissions: firstly, that the object of the Code is not to replace debt adjudication and enforcement under the Act or any other statutes and secondly, that the pendency of a Section 34 petition under the Act is reflective of a real dispute between the parties. The second contention was in light of the fact that if the cross-claims of the Appellant so rejected by the arbitral tribunal are subsequently held to be wrongly dismissed, then the Appellant would not owe any sum of money to the Respondent.

The Respondent's submissions relied on insolvency laws in foreign jurisdictions such as Singapore and Australia, which suggested that insolvency proceedings do not get stalled because an application to set aside the judgment, order or decision is pending in an appeal or otherwise. The Respondent also contended that Section 238 of the Code, is a non-obstante clause which will override provisions of the Act in any event.

## Findings and Conclusions

- The Supreme Court placed reliance on its landmark judgment in *Mobilox Innovations Private Limited v. Kirusa Software Private Limited* (2018) 1 SCC 353, and affirmed that the insolvency process, particularly in relation to operational creditors, cannot be used to bypass the adjudicatory and enforcement process of a debt contained in other statutes.
- The Court held that in so far as operational debt is concerned, all that has to be determined by the Adjudicating Authority is whether the said debt can be said to be disputed. Accordingly, the Court decided that the filing of a Section 34 petition against an arbitral award proves that there is a "pre-existing ongoing dispute" which arose between the parties in the first stage of the arbitral proceedings, and may continue to exist even after the award, till the final adjudicatory process under Sections 34 and 37 of the Act has concluded.
- The Court gave due weightage to the fact that the counter-claim of the Appellant was for amounts far exceeding the award given in favour of the Respondent, and the very fact that there was a possibility that KCPL may succeed on these cross-claims is sufficient to state that the operational debt cannot be said to be an undisputed debt.
- The Supreme Court also held that since there were no inconsistencies between the provisions of the Code and the Act, the application of the non-obstante clause under Section 238 of the Act does not come into play.
- The Court observed that the Code cannot be used in *terrorem* to extract small amounts from corporate debtors and jeopardize the fate of an otherwise solvent company worth several crores of rupees, even though the said amount may not be finally payable as adjudication proceedings in respect thereto are still pending.

## Comment

The judgment of the Supreme Court is a welcome and practicable settlement of the issue and ensures that operational creditors, whose debt claims are usually smaller in quantum, are not able to put the corporate debtor into the insolvency resolution process prematurely.

This decision overturns the position assumed by the NCLT and the NCLAT that proceedings pending under Section 34 of the Act do not imply the existence of a dispute and that an arbitral award that has been challenged does not constitute a record of the operational debt. The Court rightly held that whilst the final adjudication of a challenge to an award is pending under the Act, the provisions of the Code may not be legitimately attracted. This in effect is a harmonious construction by the Supreme Court of the two legislations, considering situations where a corporate debtor is put under the resolution process before final adjudication of a challenge to an award under the Act. If the arbitral award is subsequently set aside under Section 34 of the Act, the damage to the corporate debtor would be irreparable and the legal position under the two legislations thereby, irreconcilable.

The Supreme Court has also sent a clear message that the non-obstante clause of the Code has to be used with caution and only in cases where there exists a clear inconsistency between the provisions of the Code and some other Act.

This decision will go a long way in instilling faith of corporates in the market-driven and commercially viable approach of the Supreme Court. While the intent of the Supreme Court is to provide a workable solution for the interplay between the two statutes, it does not take into account the long procedural delays that may occur due to appeals being filed against the rejection of proceedings under Section 34 of the Act. In essence, an operational creditor may have to wait till there is a final verdict by the Supreme Court on the proceedings pending under Section 34 of the Act in order to be able to initiate proceedings under the Code.

Regardless, this decision of the Supreme Court will definitely reduce the steeply rising burden of premature insolvency applications on the NLCT and the NCLAT under the Code.

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