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NCLT MUMBAI ORDERS REFERENCE TO ARBITRATION IN AN INSOLVENCY PETITION UNDER THE IBC

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In a significant judgment dated 9 June 2020 titled '*Indus Biotech Private Limited v. Kotak India Venture Fund-I*', the National Company Law Tribunal, Mumbai Bench-IV (NCLT) allowed an application filed by the corporate debtor, Indus Biotech Private Limited, (corporate debtor) under Section 8 of the Arbitration & Conciliation Act, 1996 (Arbitration Act) seeking reference to arbitration for settlement of the disputes between the parties, while dismissing the Company Petition filed by the financial creditor, Kotak India Venture Fund-I (financial creditor) under Section 7 of the Insolvency & Bankruptcy Code 2016 (IBC).

Brief Facts

- In 2007-08, Kotak India Private Equity Group, including the financial creditor, entered into a Share Subscription and Shareholders Agreement (agreement) with the corporate debtor. The financial creditor subscribed to equity shares and Optionally Convertible Redeemable Preference Shares (OCRPS).

- The financial creditor opted to convert the OCPRS into equity shares in order to make a Qualified Initial Public Offering (QIPO) as per the applicable SEBI Regulations.

- During the QIPO process, a dispute arose between the parties regarding calculation and conversion formula to be followed while converting the respective entities' preference shares into equity shares. The financial creditor sought to apply a conversion formula which would entitle it to 30% of the total paid-up share capital of the corporate debtor, whereas the corporate debtor sought to apply a conversion formula which would entitle the financial creditor to 10% of the total paid-up share capital. Further, the financial creditor unilaterally proposed to fix a QIPO date which was objected to by the corporate debtor.

- When the dispute was ongoing, the financial creditor sent a redemption notice dated 31 March 2019 seeking early redemption of OCPRS for a sum of INR 367,08,56,503/-.

- When the corporate debtor failed to redeem the OCPRS on or before 15 April 2019 in terms of the agreement, the financial creditor filed a Company Petition under Section 7 of the IBC on 16 August 2019 seeking initiation of the insolvency proceedings against the corporate debtor.

- The corporate debtor invoked the arbitration clause in the agreement by issuing a notice invoking arbitration dated 20 September 2019.

- Thereafter, the corporate debtor filed an Application before the NCLT under section 8 of the Arbitration Act with a prayer to refer the parties to arbitration for settling their disputes.

- The Applicant/ corporate debtor also filed a petition under Section 11 of the Arbitration Act before the Supreme Court, for appointment of arbitrators.

Contentions raised on behalf of the Applicant/Corporate Debtor:

- That Section 8 of the Arbitration Act, which provides for the power of a judicial authority to refer parties to arbitration, is mandatory in nature.

- That the arbitration clause in the agreement is wide enough to cover the dispute between the parties which related to valuation of the OCRPS, fixing of QIPO date and the right of the financial creditor to redeem such OCRPS when it had participated in the process of conversion of its OCRPS into equity shares, all of which are commercial disputes.

- That the Company Petition is in the nature of a 'dressed up' petition, as the real dispute is with regard to the agreement between the parties and interpretation thereof.

- That the corporate debtor is a highly profitable and debt-free company and is in no need of resolution.

Contentions raised on behalf of the Financial Creditor:

- That a Section 7 IBC petition is incapable of being referred to arbitration as it is a matter of rights *in rem* and the reliefs sought thereunder, i.e. initiation of insolvency proceedings cannot be granted by an arbitrator.

- That the existence of an arbitration clause can never affect a Section 7 petition.

- The fact of there being pre-existing disputes between the parties is irrelevant under a Section 7 petition, though it would assume significance in a petition under Section 9 of the IBC filed by an operational creditor.

- A Section 7 petition is not for recovery of debts and once the NCLT is satisfied of there having been a financial a debt and a default having occurred in respect thereof, the NCLT should admit the petition.

- The agreement provides that if the QIPO does not take place by the QIPO date, the investment will be redeemable. If it is not redeemed, it is to be treated as a 'debt'.

Issue framed by the NCLT:

Will the provisions of the Arbitration Act prevail over the provisions of the IBC? If so, in what circumstances?

Judgment of the NCLT

The NCLT, after considering the facts of the case and various precedents passed by superior courts, as detailed hereinafter, allowed the application under Section 8 of the

Arbitration Act for reference of parties to arbitration and dismissed the Company Petition under Section 7 of the IBC, holding it incapable of being admitted at this stage.

On Arbitrability of disputes

The NCLT took note of the judgment passed by the Supreme Court in the case of *Booz Allen & Hamilton v. SBI Home Finance Ltd.,* (2011) 5 SCC 532 (*Booz Allen*), whereby it was held that generally all disputes relating to rights *in personam* (rights restricted to the parties within the contract) are considered to be amenable to arbitration and all disputes relating to rights *in rem* (rights which extend to parties outside a private contract) are required to be adjudicated by courts and tribunals. The Supreme Court further held that this principle is not rigid, and disputes relating to subordinate rights *in personam* arising from rights *in rem* are arbitrable.

Special law v. General law

The NCLT observed that it is settled law that *generalia specialibus non derogant* - special law prevails over general law. Reliance was placed upon the Judgment of the Supreme Court in the case of *Consolidated Engineering Enterprises v Principal Secretary, Irrigation Department & others*, (2008) 7 SCC 169 whereby the Arbitration Act had been held to be a special law, consolidating and amending the law relating to arbitration and matters connected therewith or incidental thereto.

The NCLT further summarized the rules of interpretation of general law versus special law as follows:

a. If the subsequent law does not repeal the earlier rule, there can be no presumption of an intention to repeal the earlier rule.

b. Unless the rule making authority makes an express or implied indication to the contrary, the Court should endeavour to harmoniously construe provisions of the general and special law.

c. If inconsistency subsists, prior special law is not presumed to be repealed by later general law. The prior special law will continue to apply.

d Where a later special law is inconsistent with an earlier general law, the later special law will prevail over the earlier general law.

Reference to Arbitration under Section 8 of the Arbitration Act

The NCLT went on to hold that Courts have a mandatory duty to refer the parties to arbitration where an arbitration clause exists, placing reliance on Supreme Court judgements in the matters of *Hindustan Petroleum Corporation Limited v Pinkcity Midway Petroleums*, (2003) 6 SCC 503 and *Gajapathi Raju & others v PVG Raju (dead) & others*, (2000) 4 SCC 539.

Section 7 of the IBC

The NCLT observed that the IBC mandates the Adjudicating Authority to ascertain and record satisfaction as to the occurrence of default before admitting the application. Therefore, there has to be a judicial determination by the Adjudicating Authority as to whether there has been a 'default' within the meaning of section 3(12) of the IBC (*Innoventive Industries Limited v ICICI Bank*, (2017) SCC OnLine NCLAT 70).

Decision

In view of the foregoing observations and considerations, the NCLT finally held as follows:

(1) On a perusal of the contentions and facts, the NCLT was not satisfied that a 'default' has occurred.

(2) It will be unnecessary to push a solvent, debt-free and profitable company into insolvency and no meaningful purpose will be served.

(3) The disputes that form the subject matter of the underlying Company Petition, viz., valuation of shares, calculation and conversion formula and fixing of QIPO date are all arbitrable, since they involve valuation of the shares and fixing of the QIPO date. Therefore, an attempt must be made to reconcile the differences between the parties and their respective perceptions.

As such, the application under Section 8 of the Arbitration Act filed by the applicant/corporate debtor came to be allowed and the Company Petition under Section 7 of the IBC filed by the Financial Creditor was dismissed.

Comment

It appears that the NCLT while passing the judgment failed to consider a significant question of law raised by the financial creditor, i.e. whether an insolvency petition can be referred to arbitration in light of the fact that the arbitrator does not have the jurisdiction to initiate the corporate insolvency resolution process, i.e., the relief sought by the financial creditor? The NCLT did not take into consideration the fact that the Supreme Court has expressly held in the cases of *Booz Allen* and in *Haryana Telecom v Sterlite Industries (India) Ltd.,* (1999) 5 SCC 688, that insolvency and winding up matters are non-arbitrable and an arbitrator has no jurisdiction to order winding up of a company.

Interestingly, in the case of *Shalby v Dr. Pranav Shah* (2018 SCC OnLine NCLT 137), NCLT Ahmedabad Bench when faced with a similar Application for reference to arbitration in an insolvency petition pending before it, dismissed the said application imposing heavy costs upon the applicant. It was held that irrespective of an arbitration clause in the agreement between the parties, the arbitrator does not have jurisdiction over the subject matter of an insolvency petition. The argument that the insolvency resolution process is not a right *in rem* was rejected by NCLT Ahmedabad.

Additionally, expressly refraining from admitting a petition under Section 7 of the IBC against an otherwise "solvent, debt-free and profitable company", as in the instant case, may be contrary to the settled position of law that under Section 7, the moment the Adjudicating Authority is satisfied that a default has occurred, the petition must be admitted, as held by the Supreme Court in *Innoventive Industries Ltd. v ICICI Bank and Anr.*, (2018) 1 SCC 407.

- *Ajay Bhargava (Partner), Wamika Trehan (Senior Associate), Shweta Kabra (Associate)*

For any queries please contact: editors@khaitanco.com

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Mumbai
One Indiabulls Centre, 13th Floor
Tower 1 841, Senapati Bapat Marg
Mumbai 400 013, India

T: +91 22 6636 5000
E: mumbai@khaitanco.com

New Delhi
Ashoka Estate, 12th Floor
24 Barakhamba Road
New Delhi 110 001, India

T: +91 11 4151 5454
E: delhi@khaitanco.com

Bengaluru
Simal, 2nd Floor
7/1, Ulsoor Road
Bengaluru 560 042, India

T: +91 80 4339 7000
E: bengaluru@khaitanco.com

Kolkata
Emerald House
1 B Old Post Office Street
Kolkata 700 001, India

T: +91 33 2248 7000
E: kolkata@khaitanco.com