

2021/11/20

Understanding Moratorium under the Insolvency and Bankruptcy Code, 2016 and its Effect on Arbitration Proceedings

Introduction to Moratorium

The Insolvency and Bankruptcy Code, 2016 (hereinafter referred to as “**IBC**”) was enacted with a view to address the shortcomings in the insolvency laws and change the process of insolvency resolution in India. The provisions of the IBC are applicable to all corporate persons, partnership firms and individuals in case of insolvency, liquidation, voluntary liquidation or bankruptcy. Upon occurrence of a default, the resolution process under the IBC may be initiated by the debtor or a creditor. The Corporate Insolvency Resolution Process (hereinafter referred to as “**CIRP**”) may be initiated by making an application to the National Companies Law Tribunal (hereinafter referred to as “**NCLT**”). Once an application is made to the NCLT, the CIRP is to be completed within a period of 180 days. Upon admission of the application by the NCLT, a moratorium under Section 14 of the IBC is declared by the NCLT for prohibiting all kinds of legal proceedings against the corporate debtor effective from the insolvency commencement date until approval of the resolution plan or initiation of liquidation proceedings. In this article, we explain the objective behind the moratorium period as envisaged by the IBC and its effect on arbitration proceedings.

The following are prohibited upon declaration of the moratorium period:

1. The institution of suits or continuation of pending suits or proceedings against the corporate debtor including execution of any judgement, decree or order in any court of law, tribunal, arbitration panel or other authority;
2. Transferring, encumbering, alienating or disposing off by the corporate debtor of any of its assets or any legal right or beneficial interest therein;
3. Any action to foreclose, recover or enforce any security interest created by the corporate debtor in respect of its property including any action under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002; and
4. The recovery of any property by an owner or lessor where such property is occupied by or in the possession of the corporate debtor.

The above prohibitions are subject to the following conditions under the IBC:

1. That the supply of essential goods or services to the corporate debtor as may be specified, shall not be terminated or suspended or interrupted during the moratorium period.
2. The provisions contained in a) to d) above shall not apply to transactions, agreements or other arrangements as may be notified by the Central Government in consultation with any financial sector regulator or any other authority and shall not apply to a surety in a contract of guarantee to a corporate debtor. Thus, application of moratorium in the above scenarios is prohibited. The order of the moratorium shall have effect until the completion of the CIRP.

Objective behind Moratorium Period

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The purpose behind declaring a moratorium is simply to keep the corporate debtor's assets together in order to ensure that the company remains as a '*going concern*'. Although the term moratorium has not been defined under the IBC, however, the Oxford dictionary defines it to mean 'a temporary prohibition of an activity'. The Supreme Court of India ("SC")^[1] while discussing the objective behind moratorium has stated that the supply of essential goods and services to the corporate debtor during the moratorium period cannot be terminated or suspended or even interrupted, as otherwise the corporate debtor would be brought to its knees and would not be able to function as a going concern. The SC further observed in another case^[2], that *the primary focus of the IBC is to ensure the revival and continuation of the corporate debtor by protecting the corporate debtor from its own management and from a corporate death by liquidation. The IBC is a beneficial legislation which puts the corporate debtor back on its feet, not being a mere recovery legislation for creditors.*

In another case^[3], the issue before the Delhi High Court ("DHC") was whether the word '*proceedings*' used in Section 14(1)(a) of the IBC means all legal proceedings or whether it is to be read restrictively to mean a particular type of legal proceeding viz., 'debt recovery action' which may have an effect of dissipating or diminishing the debtor's assets during the period of its insolvency resolution. The DHC in this case *inter alia* held that the term '*proceedings*' does not mean all proceedings and that moratorium would not apply to proceedings which are for the benefit of the corporate debtor. The rationale behind this being that there should be no additional stress on the corporate debtor's assets during the insolvency process. With this rationale, in this case, the DHC held that proceedings under the Arbitration and Conciliation Act, 1996 need not be stayed (*discussed in more detail below*).

Owing to the ambiguity in the laws and the absence of a consistent framework, the interplay between arbitration and insolvency laws has evolved as a grey area often leading to friction at various stages of proceedings under both the laws. In the next section we have discussed briefly the effect of moratorium on arbitration proceedings as developed through judicial precedents.

Effect of Moratorium on Arbitration Proceedings

The DHC in the case of Power Grid^[4] as explained above clarifies the scope of moratorium by stating that the imposition of moratorium would depend upon the nature of the proceedings and whether it is in favour of the corporate debtor or against it i.e. whether it would have the effect of diminishing or adversely impacting the corporate debtor's assets during insolvency resolution. In this case, it was held that the stay of proceedings against an arbitral award in favour of the corporate debtor would have the effect of stalling the corporate debtor's efforts to recover money and thus such proceedings would not be hit by the embargo of moratorium under the IBC.

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Source: Istockphoto[/caption]

In cases where arbitration proceedings have been initiated after the imposition of moratorium, the Supreme Court^[5] has held that such arbitration proceedings are non-est in law. Whereas in cases where arbitration proceedings have been initiated before declaration of moratorium, the same would depend on two factors i.e. a) whether the claims are against the corporate debtor; or b) whether the claims are made by the corporate debtor. In the first scenario, moratorium would stand as a legal wall. The NCLAT (appellate tribunal) in the case of *Jharkhand Bijli Vitran Nigam Ltd. v. IVRCL Ltd. & Anr.*^[6] while deciding on whether a counter claim can proceed during the period of moratorium while the NCLT allowed the corporate debtor to pursue the claim before the arbitral tribunal held that although arbitration

proceedings can continue for determining the claim and counter claim, however, no amounts shall be recovered from the corporate debtor during the continuation of the moratorium period. Thus, the outcome of the proceedings would be the main criteria in determining imposition of moratorium. If the claims are proved against the corporate debtor making it liable to repay debt by liquidating its assets, then moratorium would be placed and the order will not be executed during the continuance of insolvency. Thus, arbitrations involving claims and counter claims made by and against the corporate debtor may not be hit by moratorium during the pre-award stage. Moratorium would come into effect depending upon the nature of the award and if it is against the corporate debtor i.e. leading to diminishing of its assets. Further, in the case of *SSMP Industries Ltd. v. Perkan Food Processors Pvt. Ltd.*^[7] the DHC held that the adjudication of a counter claim would not be liable to be stayed in view of Section 14 of the IBC till the time there is no threat to the assets of the corporate debtor and the continuation of the counter claim would not adversely impact the corporate debtor's assets. Once the counter claims are adjudicated and the amount to be paid/recovered is determined, then at that stage or in execution proceedings, depending upon the situation prevalent, Section 14 could be triggered.

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^[1] P. Mohanraj and Others v. Shah Brothers Ispat Pvt. Ltd. 2021 SCC Online SC 152

^[2] Swiss Ribbons Pvt. Ltd. &Anr. v. Union of India, Writ Petition (Civil) No. 99 of 2018.

^[3] Power Grid Corporate of India Ltd. Jyoti Structures Ltd. O.M.P.(COMM.) 397/2016

^[4] *Ibid.*

^[5] Alchemist Asset Reconstruction Company Limited v. Hotel Gaudavan Private Limited and Others 2017 SCC Online SC 1669

^[6] Company Appeal (AT) (Insolvency) No. 285 of 2018

^[7] CS (COMM) 470/2016