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Cross Border Insolvency: The Utility of Alternate Dispute Resolution (ADR) Mechanism

Insolvency and Bankruptcy Code 2016 (IBC) provides a creditor-in-control mechanism for resolving financially stressed companies. However, the experts across economies are unanimous that the creditors should use insolvency processes as a last measure when all the previous mechanisms of Alternative Dispute Redressal (ADR) such as restructuring, settlement, arbitration, mediation etc., are exhausted. Besides, various tools of ADR are also quite useful to sort of issues at the level of resolution professional and Committee of Creditors (CoC) thereby avoiding maximum possible litigations and interlocutory applications (IAs) which further delay the insolvency processes. As cross-border insolvencies involve more than one and sometimes several jurisdictions, ADR can play a crucial role in resolving such companies before and during the IBC processes. ***Read on to know more…***

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Productive enterprises are the backbone of a country's prosperity and its comprehensive national power. The Insolvency and Bankruptcy Code 2016 (Code/IBC) emphasizes the need for the timely resolution of financial stress to prevent value loss resulting from the failure of an economic entity or value destruction arising out of its unplanned closure.

The National Company Law Appellate Tribunal (NCLAT) in the matter of *Binani Industries Ltd. Vs. Bank of Baroda and ors*., clarified the goals of the Code in these words, "The first order objective is resolution. The second order objective is maximization of the value of assets of the Corporate Debtor (CD) and the third order objective is promoting entrepreneurship, availability of credit and balancing the interests. This order of objective is sacrosanct." Thus, the main objective of the Code is 'to save the company ', regardless of its area of operations – domestic or overseas.

Role of ADR in Cross Border Insolvency proceedings

Given the above backdrop, the need for an efficient and flexible mode of corporate rescue in respect of Cross Border Insolvencies, assumes importance. As a support to

the UNCITRAL Model Law, recourse to the Alternate Dispute Resolution (ADR) Mechanism is available in some jurisdictions for use at various stages of Cross Border Insolvency. It regroups all processes and techniques of conflict resolution that occur outside of any governmental authority. The most commonly used ADR methods are: arbitration, mediation, negotiation, conciliation and transaction, of which the first three are the most in vogue.

Arbitration v/s Mediation

Although arbitration and mediation appear to have similar features as resolution modes, they are fundamentally different.

Arbitration is a determination of legal rights and leads to a binding determination, whereas

Mediation is a form of facilitated negotiation which looks beyond rights and allows the parties to focus on their underlying interests. It results in a binding determination only if the parties agree to settle their dispute on mutually satisfactory terms.

In the last 30 years, ADR has become an almost intrinsic part of dispute resolution clauses in international commercial contracts.

ADR Enforceability

The difference between enforceability of a court judgment and that of an arbitral award also favors use of arbitration in International Commercial Disputes Resolution.[2]

While the UNCITRAL Model Law (1997) on Cross-Border Insolvency has been accepted in 44 countries, including the USA and the UK, it is not a multilateral convention with a uniformly enforceable framework. In fact, Article 6 of Model Law expressly states that," nothing in this law prevents the court from refusing to take an action governed by this law if the action would be manifestly contrary to the public policy". Thus, many countries, including the USA, UK and Singapore, have incorporated public policy exemptions, as necessary, in their adopted version. Even the draft legislation proposed to be enacted in India has sought to build in caveats relating to domestic public policy. As such, the Model Law provides only a format, to be adapted locally, for proceeding with Cross Border Insolvency in the limited group of the 44 signatory countries and is not a globally applicable rule bound procedure.

The United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards ("New York Convention -1958") provides a more wide-reaching option than the currently evolving UNCITRAL Model Law – particularly with reference to Indian Cross Border Insolvencies. The New York Convention has been described as "the single most important pillar on which the edifice of international arbitration rests." It may not be out of place to mention that in India, the Companies Act of 2013 and the MSME Act of 2006 provide for ADR. As such a comprehensive body of jurisprudence has evolved to give effective form to Mediation and Arbitration, etc., as acceptable dispute resolution processes, which may be extended to Cross Border Insolvencies as applicable. In the Indian context it may also be necessary to grant recognition to ADR for CIRP/Cross Border Insolvency by incorporating suitable changes to IBC.

Since there are currently 142 countries out of the 192 United Nations Member States that have adopted the New York Convention, the vast majority of international arbitration agreements are within its ambit. Under the New York Convention, if an arbitration award is issued in any country that is a party to the Convention, every other party to the Convention is legally obligated to enforce the award

ADR –Effectiveness for Cross Border Insolvency

ADR can be a useful tool in the pre-Insolvency resolution on the lines of the Pre-pack option for MSMEs or in the post CIRP stage before Liquidation. It can provide the following advantages:

(i) Settlement without public disclosure of dispute

This may facilitate a resolution without registering the recognition of default and dispute through a formal Insolvency initiation. The process may precede the invocation of CIRP and its attendant restraints on the CD. This would be useful in case of multiple locations of CD's operations, each of which may lose enterprise value due to actions in a separate jurisdiction

[1] Corporate Council Business Journal – RJ Aliment, Williams Kastner.

(ii) Cost Effective Mechanism

Formal insolvency processes under the Code/ Cross Border Insolvency requirements, can be time-consuming and involve significant direct and indirect costs. On the other hand ADR may provide a flexible and economical option for resolving claims and disputes. In case of Cross Border Insolvencies, the provisions of Arbitration Decree may be easier to execute assisted by the enabling Convention applicable to the member countries.[2]

(iii) Company as Going concern – Saving Value

Since the CD continues to function in a "Debtor-in-Possession" mode, there is little disruption in operations and a continuity in functioning which prevents sharp decline in enterprise valuations. This is relevant in respect of an Indian MNC which may experience a sharp loss of value as its overseas operations grapple with the initiation of domestic CIRP or Bankruptcy action in other countries.

ADR for Insolvency Resolution

(i) **United States:** The US has been a pioneer in using ADR/Mediation at various stages of Bankruptcy proceedings. The process received a fillip following the enactment of the Alternate Disputes Resolution Act (1998). ADR/Mediation was effectively used in the case of Lehman Brothers Holding to repay the creditors. The criteria to determine whether specific disputes relating to an insolvency were arbitrable or non-arbitrable depends on whether it is categorized as a core or non-core feature under Section 157 of Title 28, United States Code.

(ii) **Switzerland:** Article 177(1) of the Swiss Private International Law Act (PILA) states that any dispute involving economic interest is arbitrable. However, there is one exception i.e. "core issues" related to insolvency and bankruptcy shall not be arbitrable. This includes "initiation of insolvency proceedings, appointment of trustees etc." All other bankruptcy matters can be the subject of arbitration.

(iii) **England:** The general provision is that "insolvency matters disputes do not affect the ability of a party to proceed with arbitration". However, the arbitrability of insolvency matters depends upon whether the dispute engages third party rights or is there public interest involved. This includes payment made to third party creditors.

(iv) **Chile:** Though Specialized Insolvency courts have been set up in Chile, to shorten the long process of reorganization of the distressed companies, Insolvency Arbitration has now been included within the framework of Chilean insolvency law. Thus, parties (Debtor and Creditor) have the liberty to choose arbitration while their reorganization proceedings are underway. However, debtor consent is not required for Liquidation of companies. The reason for adoption of Insolvency Arbitration is to reduce the burden on the Bankruptcy court.

(v) **Australia:** The leading case of ACD Tridon Inc v. Tridon Australia Pty Ltd. allows that "while most matters under the Corporations Act could be referred to arbitration (if the clause was worded appropriately and that matters concern the parties' rights stemming from contract rather than statute), the parties could not refer to arbitration matters relating to the winding up of a corporation, as this is a matter stemming from statute and involves interest of third parties."

Legal Impediments to ADR under IBC

Insolvency proceedings in India are not the subject matter of arbitration. The moratorium gets triggered when an application under Section 7, 9 or 10 of the IBC is admitted by the tribunal. However, proceedings under the Arbitration Act can continue till the admission of the application under the IBC.[3]

In the matter of the *Indus Biotech Private Limited Vs Kotak India Venture and Ors.,* Supreme Court has held that in any proceeding which is pending before the Adjudicating Authority under Section 7 of IBC, if such petition is admitted upon the Adjudicating Authority

[2] Parul, Jagannath University Research Journal (JURJ) Volume No.-II, Issue No.–II, November, 2021, ISSN: 2582-6263

[3] Source Alternative Dispute Resolution (ADR) and IBC Resolution Professional July 2021- Manish Paliwal

recording the satisfaction with regard to the default and the debt being due from the corporate debtor, any application under Section 8 of the Act, 1996 made thereafter will not be maintainable.

In a situation, where the petition under Section 7 of IBC is yet to be admitted and, in such proceedings, if an application under Section 8 of the Indian Arbitration and Conciliation Act, 1996 is filed, the Adjudicating Authority is duty bound to first decide the application under Section 7 of the IBC by recording a satisfaction with regard to there being default or not, even if the application under Section 8 of Act, 1996 is kept along for consideration.

Section 14 of the IBC provides that the adjudicating authority while admitting the application for insolvency shall by order declare moratorium for prohibiting the institution of any proceedings against the CD. This creates an additional hurdle in arbitrating the disputes arising during the pendency of the CIRP. In the matter of the SSMP Industries v Perkan (2019) DRJ 473, it was held by the High Court of Delhi that until and unless the proceeding has the effect of endangering, diminishing, dissipating, or adversely impacting the assets of the corporate debtor, it would not be prohibited under Section 14(1)(a) of the IBC. However, if continuing the ADR proceeding is not against the interests of the CD, such proceedings can continue even after the moratorium.

Consent is the key element of the ADR proceedings. Parties are bound by the outcome of the ADR proceedings if they have consented to the same.

Proceedings like mediation, conciliation and expert determination are not proceedings against the CD. Consent is the key element of the ADR proceedings. Parties are bound by the outcome of the ADR proceedings if they have consented to the same. Besides, under ADR proceedings no order, which disturbs the priority provided in Section 53 of the IBC, can be passed against CD.

Contribution of ADR to facilitating Cross Border Insolvency

India's growing global engagement requires the setting up of an effective Cross Border Insolvency Resolution Mechanism for timely revival of a faltering enterprise or improving its realizable salvage value. Where ADR can be applied to the various jurisdictions that a CD operates within, it may facilitate the process in the following manner:

a. Some disputes will be resolved through ADR and it will reduce the number of applications filed before the Foreign/Domestic Adjudicating Authority (AA).

b. Since one attempt would have been made under ADR, the compete documents and pleadings regarding the application can be made available to AA without delay.

c. AA may refer to the ADR filings/records to expedite and facilitate decision making.

d. RPs may use various tools of ODR/ADR which could make the process more efficient and improve value salvaging.

e. Use of ADR or expert determination to resolve the valuation disparities and disputed transactions may reduce the time taken and the work of the AA.

Conclusion

The need for having a robust framework addressing all issues pertaining to cross-border insolvency has been long felt. Although various committees constituted by the Government have highlighted the importance of effective resolution of Cross Border Insolvencies, the present framework comprising of Section 234 and 235 IBC are inadequate to cover all aspects of insolvency. The need for a comprehensive framework is highlighted by the growing engagement of Indian Corporates with foreign counterparties and their increasing multinational footprints.

While the Model Law is a constructive step taken towards building such a mechanism, it is also not independent of various shortcomings. As discussed in the preceding paragraphs, the Model Law may need to be supported with the options available under ADR which do not conflict with the "Core" features of IBC, for improving its effectiveness.

Money has a time value. More than enhancing recovery, the value is best saved, if not enhanced, by timely action and restoration of viability. Where time is of essence and dispute resolution is necessary for value retention, the utility of an ADR for various stages of Cross Border