

Insolvency and Bankruptcy Hotline

July 13, 2022

CAN PROCEEDINGS UNDER INSOLVENCY CODE REPLACE EXECUTION OF ARBITRAL AWARDS?

- A final judgment or decree passed by a court/tribunal would constitute a valid proof of debt for initiation of insolvency proceedings under the Insolvency and Bankruptcy Code, 2016;
- The final judgment or decree will give rise to a fresh cause of action for initiation of insolvency proceedings under the IBC;
- The underlying nature and character of a debt would define the category of a creditor making a claim under a judgment or decree;

Recently, the Supreme Court of India (“**Supreme Court**”) in *Kotak Mahindra Bank Limited v. A. Balakrishnan*¹ has held that once a claim has fructified into a *final* judgment post adjudication by a tribunal or court, the amount payable under the judgment, decree, order or recovery certificate, will give rise to a fresh cause of action in favour of the creditor. It also held that such a decree could be used as a proof of debt to initiate proceedings under the Insolvency and Bankruptcy Code, 2016 (“**IBC**”) within three years from the date of the decree.

BACKGROUND:

In this case, Kotak Mahindra Bank Limited (“**KMBL**”), had initiated recovery proceedings under the Recovery of Debts and Bankruptcy Act, 1993 against the borrower entity. The Debt Recovery Tribunal (“**DRT**”) had issued a recovery certificate against the borrower entities in the recovery proceedings. Basis the recovery certificates, KMBL initiated Corporate Insolvency Resolution Proceedings (“**CIRP**”) against the Corporate Debtor under the IBC. The National Company Law Tribunal (“**NCLT**”) allowed the application under the IBC, and initiated CIRP against the borrower entity. Thereafter, the order of the NCLT was assailed before the National Company Law Appellate Tribunal (“**NCLAT**”) and subsequently before the Supreme Court by the director of the borrower entity.

DECISION OF THE SUPREME COURT:

The Supreme Court held that the liability in respect of a claim arising out of a recovery certificate issued by the DRT would be considered a “financial debt” within the ambit of Section 5(8) of the IBC. Further, it was held that the underlying claim of the Bank/Claimant under the lending documents would have to be categorized as a “*financial debt*” under the IBC. Therefore, a recovery certificate issued in respect of the same claim, which is essentially a crystallization of the claim through the process of adjudication, had to *also* be classified as a “financial debt” under the IBC. Consequently, the nature of the underlying claim of the creditor, would determine the categorization of the amount payable under the final decree passed through adjudication of the same claim. The liability arising out of an arbitral award or a court decree would be categorized as either financial or operational debt depending on the nature of the underlying claim which stands crystallized through the arbitral or court proceedings.

ANALYSIS:

The Supreme Court while referring to an earlier judgment² has used the word “*final*” before judgment, order and decree. Therefore, for a creditor to be able to initiate proceedings under the IBC by using a judgment, order or decree, the same should have attained finality. In the present factual scenario, an order had been passed by the DRT along with a recovery certificate recording the amount payable by the debtor company. Although this order of the DRT was appealable, the Supreme Court does not mention any such appeal being filed by the debtor company, therefore, it can be assumed that the order of the DRT had attained finality when an application was filed seeking initiation of CIRP. However, if an appeal had been filed before the Debt Recovery Appellate Tribunal against the order and recovery certificate, could the creditor initiate proceedings under IBC during the pendency of the appeal process? We have some guidance on this aspect from another judgment of the Supreme Court in *K.Kishan v Vijay Nirman Company Pvt Ltd*³, wherein an operational creditor had received a favorable arbitral award which was sought to be set aside by the judgment debtor under Section 34 of the Arbitration and Conciliation Act, 1996 (“**Arbitration Act**”). During the pendency of the setting aside proceedings, the operational creditor filed an application before the NCLT seeking initiation of insolvency proceedings basis the arbitral award. The Supreme Court stated that the pendency of setting aside proceedings amounted to a *pre-existing dispute* therefore prohibiting the operational creditor from filing the insolvency application till completion of the challenge proceedings under Section 34 of the Arbitration Act, or enforcement proceedings under Section 37 of the Arbitration Act. However, in case of financial creditors, there is no bar on filing of an insolvency petition in case of a *pre-existing dispute*. Therefore, if a financial creditor has a favorable arbitral award or a court decree, the same could be treated as (a) a

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fresh cause of action and (b) a valid proof of debt for initiation of insolvency proceedings under the IBC.

There have been a series of NCLAT judgments⁴ which observed that insolvency proceedings cannot be used to circumvent execution proceedings and that a creditor cannot use an order or decree as a proof of debt to initiate insolvency proceedings. However, with the present Supreme Court judgment, it is evident that a creditor may choose to initiate insolvency proceedings using an award or decree instead of proceeding with execution of such an award or decree.

Whether it would be beneficial for a creditor to choose insolvency or execution would depend on multiple factors like (a) whether the amount payable under the award is secured; (b) whether the debtor is saleable as a going concern; (c) whether the debtor is highly leveraged; and (c) whether the creditor can financially support the insolvency resolution process.

For ease of reference, we have provided a tabular summary of the different scenarios, where a financial or operational creditor can use a judgment or decree to initiate insolvency proceedings.

| Category of judgment or award | Position for a Financial Creditor | Position for an Operational Creditor ⁵ |
|---------------------------------------|--|--|
| Domestic Arbitral Award | Award holder should be able to initiate CIRP irrespective of whether any setting aside or challenge proceedings are pending unless there is a stay on the operation of the Award | Award holder cannot initiate CIRP until completion of any setting aside or challenge proceedings |
| Foreign Arbitral Award | <p>Once the award is enforced and recognized as a decree of an Indian Court⁶, the award holder should be able to initiate CIRP irrespective of whether any challenge proceedings are pending against the order of recognition, however the award should be final and binding as per the laws of the foreign jurisdiction.</p> <p>However, the Mumbai bench of the NCLT in <i>Agrocorp International Private (PTE) Limited v. National Steel and Agro Industries Limited [CP (IB) No. 798/MB/C-IV/2019]</i>⁷ has taken an opposite view. In this case, it held that enforcement of a foreign award is not required for successfully maintaining an insolvency claim against the corporate debtor. In this case, the foreign award was not challenged, and that was used as a basis to admit the insolvency petition.</p> <p>However, the ruling was not followed by the Hyderabad bench of NCLT in <i>Adityaa Energy Resource Pte Ltd. v. Simhapuri Energy Ltd</i>⁸, wherein a foreign award was the basis for initiating CIRP. The NCLT rejected the application and accepted the contention that the foreign award had to be enforced in India before it can be relied as a valid proof of debt.</p> | Once the foreign award is enforced and recognized as a decree of an Indian Court, the award holder should be able to initiate CIRP unless any challenge proceedings are pending against the order of recognition, however the award should be final and binding as per the laws of the foreign jurisdiction. |
| Domestic Civil Decree | Decree-Holder should be able to initiate CIRP irrespective of whether any challenge proceedings are pending unless there is a stay on the operation of the Decree. | Decree-Holder cannot initiate CIRP if any challenge proceedings are pending. |
| Order passed by Tribunals such as DRT | Decree-Holder should be able to initiate CIRP irrespective of whether any challenge proceedings are pending unless there is a stay on the operation of the Decree | Decree-Holder cannot initiate CIRP if any challenge proceedings are pending. |

– Arjun Gupta & Alipak Banerjee

(The authors would like to acknowledge and thank Shreyansh Jain for his assistance on this hotline.)

You can direct your queries or comments to the authors

¹ 2022 SCC OnLine SC 706

² Dena Bank (Now Bank of Baroda) vs C.Shivakumar Reddy(2021) 10 SCC 330

³ (2018) 17 SCC 662

⁴ Sushil Ansal vs Ashok Tripathi , 2020 SCCOnline NCLAT680 (Para 20), G.Eshwara Rao vs Stressed Assets Stabilisation Fund, 2020 SCCOnline NCLAT 416

⁵ The Supreme Court in *K.Kishan v Vijay Nirman Company Pvt Ltd* has affirmed that even though arbitral awards are valid records of an operational debt, the same would have to be undisputed in order to enable initiation of the corporate insolvency resolution process by

operational creditors.

⁶ *Fuerst Day Lawson Ltd v. Jindal Exports* [2001] 6 SCC 356; *Government of India v. Vedanta Limited & Ors*, SLP (Civil) No. 7172 of 2020.

⁷ Paragraph 37: *“This Bench is of the considered view that it is not possible to wait indefinitely for the Corporate Debtor to challenge the Arbitral Award, and that it has to decide the present petition on the basis of the admitted positions, that is to say, there is an Arbitral Award passed by a competent Arbitral Tribunal after the consideration of the positions of both the sides, and there is no challenge to the Arbitral Award dated 16.04.2018 in a manner known to law. Hence the same cannot be considered as a pre-existing dispute, and the objection of the Learned Counsel for the Corporate Debtor on this count is rejected . . .”*

⁸ [NCLT Hyderabad, CP(IB) No. 389/9/HDB/2018]. We understand that the decision has been appealed before the NCLAT [Company Appeal (AT)(Ins) - 1038/2019] and is pending adjudication.

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