



LIQUIDATION OVER ARBITRATION? – ANALYSING SURANA POWER v. BHEL

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Introduction

In a battle between choosing liquidation or arbitration, most parties, including the judicial authorities, would prefer to choose the latter for it allows settlement of monetary disputes outside the court of law. Insolvency and Bankruptcy Code 2016 dots the settlement mechanism so much so that the first course of action for insolvency disputes is a resolution process. Albeit the CIRP is different from other outside the court settlement mechanism since it involves access to the Adjudicating Authorities under IBC. Till date, 469 CIRPs have been appealed, reviewed, settled, or withdrawn; and 221 have reached settlement via Resolution Plans.¹

The case of Surana Power v. BHEL lays open the limitations of a binding arbitral award to an insolvency process resulting in liquidation. In its most liberal sense, arbitration is a substitution, by consent of parties, for the tribunals provided by the ordinary process of law.² When we probe this definition, we find that “consent of parties” implies all parties to the dispute. In the present case, the Respondent- BHEL, a secured financial creditor was the sole accessory to an arbitration with the Corporate Debtor, among the secured financial creditors to the Corporate Debtor. While that in itself is not problematic, given certain conditions are satisfied³, the other circumstances in the case are significant in understanding where the provisions of IBC draw lines to allow for fairness among stakeholders of the Corporate Debtor.

Brief Facts & NCLATs Judgement

Insolvency process against the Corporate Debtor (CD), Surana Power Limited was initiated on February 19, 2018.⁴ Upon the lack of an approved resolution within the Committee of Creditors (CoC), liquidation was ordered soon after.⁵ Previously on January 24th, 2018 the Respondent, BHEL had received an ex-parte arbitral award against the CD . The award granted BHEL lien over the secured assets of the

¹ The Quarterly Newsletter of Insolvency and Bankruptcy Board of India. Jan-March 2020, Vol.14.

² Arbitration Law and Practices in India: Recent Developments and Impact of Globalization, Anil Kumar. Thesis. Aligarh Muslim University. 2013. Shodhganga.

³ Section 52 of the Insolvency and Bankruptcy Code 2016

⁴ Order of February 19, 2018, In the matter of Surana Power Limited CP-646-(IB)-CB-2017

⁵ Order of January 28, 2019, In the matter of Surana Power Limited CP-646-IB-2017



CD(equipment and goods lying at the site) and a charge over its entirely or partially erected facilities at the site was created.⁶

The Liquidator in the present case was unable to liquidate the assets of the CD without all the Secured Creditors relinquishing their securities.⁷ The Respondent, BHEL was the only Secured Creditor to not provide any confirmation on their relinquishment once the liquidation proceedings were commenced until August 23rd, 2019 where they informed the Liquidator about their choice to realise their security interest under Section 52 of the IBC. The remaining Secured Creditors held 73.76% of the value of the secured assets of the CD, while BHEL held 26.24%. Despite the majority of the Secured Creditors' relinquishment, the Liquidator was unable to proceed with any further sale of assets.

Mr. Dwarkanath, the Liquidator moved to the NCLT to seek permission to sell the assets of the CD with the majority backing of the Secured Creditors. The NCLT held BHELs lien preferential over the charge of the other Secured Creditors, and the application was rejected, and thus an appeal was filed at the NCLAT. It was claimed that the Adjudicating authority had failed to appreciate the important fact that the secured creditors along with the Respondent had a charge over the Secured Assets of the CD, on which BHEL had been granted lien from the Arbitral Award, via a Hypothecated Deed dated 24th September 2010.⁸

The Appellate Authority's judgement ruled in favour of the Appellant Liquidator essentially holds that a secured creditor cannot claim superiority over other secured creditors in the same band, and that everyone must receive their fair share by following the waterfall mechanism of liquidation under Section 53 of the IBC. The NCLAT referred to the SARFAESI Act of 2002 which deals with the enforcement of security interest, which states that any steps vis-à-vis realization of assets by the Secured Creditors requires confirmation from the Creditors having at least 60% of the value of total debt of the CD.⁹ It was held that stalling the liquidation process would be prejudicial to the rest of the shareholders since BHEL only possessed 26.24% share value of the Secured Assets. Thus, the relinquishment of the security interests of the other secured creditors sharing 73.76% shall be binding on the Respondent.¹⁰

Relationship between Arbitrations & IBC

There are a multitude of scenarios which involve the clash between insolvency or liquidation proceedings under the IBC and the arbitral proceedings. Mainly, orders have

⁶Mr. Srikanth Dwarkanath, Liquidator of Surana Power Limited Vs. Bharat Heavy Electricals Limited CA(AT)(Ins)No. 1510 of 2019

⁷ Under Regulation 32 of the IBBI (Liquidation Process) Regulations, 2016

⁸Mr. Srikanth Dwarkanath, Liquidator of Surana Power Limited Vs. Bharat Heavy Electricals Limited CA(AT)(Ins)No. 1510 of 2019

⁹ Section 13(9) of the SARFAESI Act 2002

¹⁰Mr. Srikanth Dwarkanath, Liquidator of Surana Power Limited Vs. Bharat Heavy Electricals Limited CA(AT)(Ins)No. 1510 of 2019



been passed in cases where the concerning issues deal with arbitral proceedings and awards after a CIRP is initiated and moratorium under Section 14 of the IBC- which bars the initiation and continuation of any judicial proceedings until the CIRP or Liquidation is finalised, is imposed. The intricacies of imposing a moratorium on any and all proceedings against the CD are significant to the whole insolvency and liquidation process. The table below enlists certain major scenarios.

Possible Scenarios	Legal Position	Cases
Arbitral claims made by the CD	The arbitration claim by the CD will continue or can be instituted after the CIRP is initiated. Since, Section 14(1)(a) only explicitly bars the institution of suits or continuation of pending suits or proceedings against the CD .	
Arbitral claims made against the CD	The arbitration proceedings will not continue or can be instituted after the CIRP. Since, Section 14(1)(a) explicitly bars the institution/continuance of arbitration proceedings against the CD.	<i>Alchemist Asset Reconstruction Company Ltd. v Hotel Gaudavan Pvt. Ltd.</i> ¹¹
Arbitral claims and counter claims made by the CD and the Opposite Parties	Pre-award stage of the Arbitral proceedings may not fall under the purview of Section 14(1)(a).	<i>Jharkhand Bijli Vitran Nigam Limited v IVRCL Ltd. (Corporate Debtor) & Anr.</i> ¹²
Arbitral proceeding which had commenced before the CIRP under IBC	IBC provisions¹³ override the Arbitration Act 1996. After initiation of CIRP, all parties pending arbitration along with the Creditors of the CD can file claims before the Resolution Professional.	<i>K.S. Oils Ltd. v The State Trade Corporation of India Ltd. & Ors.</i> ¹⁴
Arbitral award given in favour of CD	Section 14 of the IBC does not bar the recovery of dues ¹⁵ owed to the CD.	
Arbitral award given against the CD	Section 14 of the IBC bars recovery of dues ¹⁶ against the CD.	

¹¹ AIR 2017 SC 5124

¹² Company Appeal (AT)(Insolvency) No. 285

¹³ Section 238 of the Insolvency and Bankruptcy Code

¹⁴ NCLAT, Company Appeal (AT) (Insolvency) No. 284 of 2017

¹⁵ Section 30 of the Arbitration and Conciliation Act 1996

¹⁶ Ibid



The case of Surana Power unique in the aspect of the relationship shared between arbitral proceedings and the IBC. In the present case, the Arbitral Award was given in prior of the initiation of the CIRP, and thus the liquidation process. The Respondent, in defence, had raised the case of *JM Financial Asset Reconstruction Company Ltd. Vs. Finquest Financial Solutions Pvt. Ltd. and Others*,¹⁷ where the same Appellate Authority in circumstances similar to the present case, held that a secured creditor had a right to realise their assets even if the same assets are claimed by the other secured creditors under various sub-sections of Section 52 of the IBC, only if the Liquidator is satisfied that they had the first charge over the secured assets compared to the other secured creditors. The last part is the dividing factor which contributed to the NCLAT's judgement against BHEL's claim, since the Liquidator had already contemplated that BHEL did not have exclusive charges over the secured assets awarded via the arbitral award in 2018 due to the presence of the Deed of Hypothecation of 2010.

Priorities under the Waterfall Mechanism

Furthermore, the waterfall mechanism gives priority to secured financial creditors over unsecured financial creditors. The mechanism says that if a company is being liquidated, these secured financial creditors must be first paid the full extent of their admitted claim before any sale proceedings are distributed to any other unsecured creditor.

Under Section 53 of the IBC, which deals with waterfall mechanism, top priority is given to costs related to the insolvency and liquidation process and dues of workmen of the CD. Followed by the debts of the Secured Creditors who relinquish their security interest, then the other employee dues and Unsecured Creditors, trickling down to the debts of the Secured Creditors who wish to realise their security interest and government dues (refer to Chart 1). The idea is that the most expensive debt should be paid first, followed by other debts and dues in priority

¹⁷Company Appeal (AT)(Ins)No. 593 of 2019

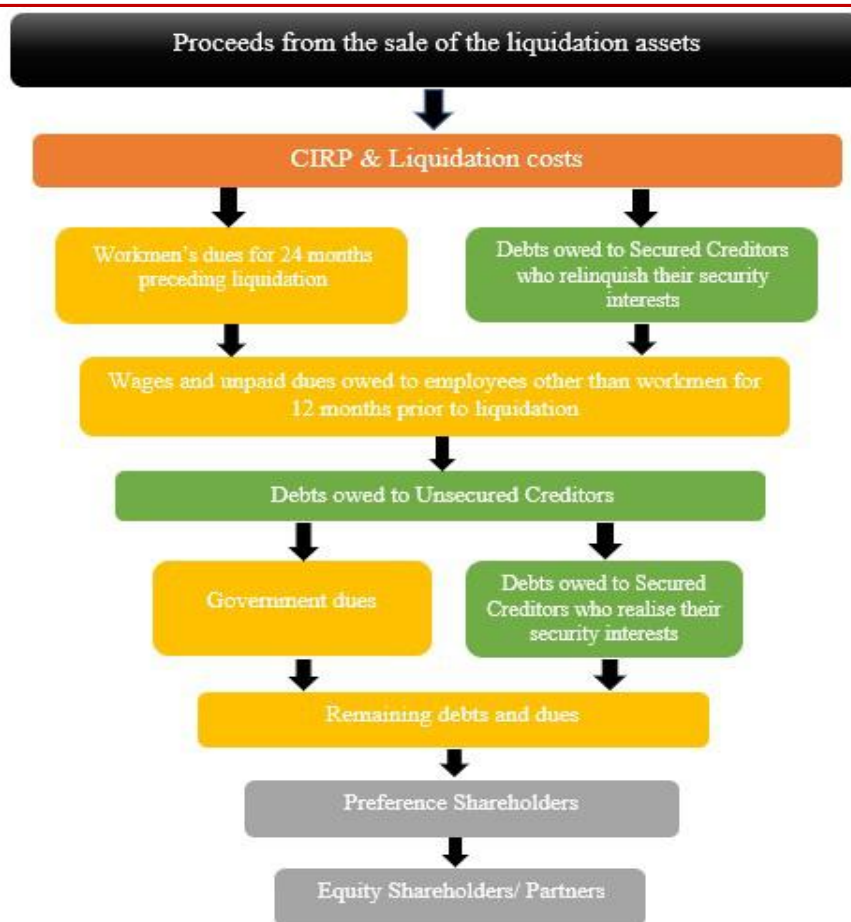


Chart 1

Conclusion

The Code gives arbitration its due when required but not to the detriment of the shareholders in an insolvency or liquidation. Various circumstances come into scrutiny to determine the efficacy of the arbitral awards and their proceedings. In the present case, if we assume that BHEL did not receive the Arbitral Award for the entire Secured assets of the CD, but a little portion equivalent to its share in the liquidation value with other 10 Secured Creditors, and BHEL wished to realise its security interest. Following the waterfall mechanism, the 10 Secured Creditors would receive their debts before BHEL, and the Appellate Authority would have upheld the decision of the NCLT. But in the present circumstances, BHEL being granted lien over the entire secured assets of the CD, while possessing only 26.24% of the asset value of the CD undermines fair distribution of debts and dues to the other participants of the waterfall mechanism,



especially the 10 Secured Creditors, especially when the Hypothecated Deed comes into play. Thus, the arbitral award was not upheld.

Discussing the importance of waterfall mechanism and same treatment to similar category of financial creditors is relevant to understanding the distribution of proceeds of the insolvency or liquidation process. As of end of 2019, the government is considering a new formula for this distribution of assets, debts and dues to reduce delays due to litigation concerning such doubt clearance as in the case at hand, ensuring the objective of the IBC is well-maintained.¹⁸

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¹⁸IBC proceeds formula may be reworked to avoid squabbles, legal delays. The Economic Times. November 13, 2019