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Insolvency Bankruptcy Proceedings and The Role of Alternative Dispute Resolution in it: A Legal Study

Bharathi G[1]

Abstract

Insolvency and bankruptcy proceedings are intricate legal processes that regulate the winding up of a company that has failed to fulfill its financial obligations. These proceedings entail multiple stakeholders, including creditors, shareholders, and debtors. Historically, courts have been instrumental in settling disputes that arise during insolvency proceedings. However, the court system can be protracted, exorbitant, and uncertain, prompting the emergence of ADR (Alternative Dispute Resolution) as a plausible alternative for resolving disputes that crop up during the insolvency process. This paper assesses the efficacy of ADR in insolvency proceedings in

[1]*Student of VIII Semester B.B.A., LL.B. (Hons), School of Legal Studies, CMR University.*

India and its potential to provide a swifter and more economical way of settling disputes. The study examines the legal framework for insolvency and bankruptcy proceedings in India, highlighting the principal stakeholders involved and the challenges that arise in resolving disputes. The research evaluates the role of ADR mechanisms, such as mediation and arbitration, in resolving disputes that arise during insolvency proceedings.

The study determines that ADR offers several advantages in insolvency proceedings, including the ability to settle disputes more effectively and economically while also enabling stakeholders to achieve mutually acceptable outcomes. Additionally, ADR mechanisms can help maintain business relationships between stakeholders, mitigating the adverse impacts of insolvency on the wider economy. However, the study also underscores some of the limitations of ADR, such as the potential for power disparities between stakeholders and the need for greater standardization and regulation of ADR procedures in insolvency proceedings.

Overall, this study offers valuable insights into the role of ADR in insolvency and bankruptcy proceedings in India, highlighting its

potential to enhance the efficiency and effectiveness of the insolvency resolution process.

Introduction

Every private company is started with a motive to earn profit, to maximize the wealth of its shareholders and to safeguard the interests of all its stakeholders, but at the end of the day, the reality is not all companies survive in the market, due to mistakes committed by its management or due to external factors, they reach the inevitable end. Once the company moves towards insolvency, the shareholders, creditors and all the other stakeholders poach the company to recover their dues out of the pool of assets of the company. In most cases the pool assets wouldn't be enough to repay dues held to its stakeholders and hence, there is always conflict of interest and there is always the question of who should be compensated first and how much should he be compensated with and these questions are answered by the courts. Indian judiciary has evolved over the years and has acknowledged the importance of bankruptcy norms, it has formulated separate tribunals for deciding the insolvency proceedings. The problem with the adjudication process is that it is time consuming and resource hungry, for a company that’s on a verge of death, both of these things are scarce. Hence, the Alternate Dispute Resolution

mode gained traction, the process of mediation would also speed up the process of the winding up and would also help all the stakeholders to come to an amicable solution. In this paper the researcher analyzes the importance, effectiveness and limitations of ADR in insolvency proceedings and how stakeholders view it.

Literature Review

The researcher went through the following articles to understand the subject matter and to analyze the depth of the subject to frame research hypotheses and questions. Analyzing the below mentioned books gave the researcher a brief idea about the subject matter.

Emergence of Commercial Justice**,** authored by Vivek Sood, this book gave the researcher an outlook on the evolution of the arbitration system and origin of insolvency adjudications and how modern-day problems require modern day solutions. The book emphasizes on the fact that, as the society progresses, the laws must also change and the process of adjudication, which takes years of time and resources, is a thing of the past and how it would be replaced by ADR mechanism within a decade.

Crossroads of Insolvency and Arbitration, authored by Ishaan Madaan and Christian Campbell, this book made researchers realize the nexus between insolvency proceedings and Arbitration proceedings. The process of arbitration is though codified and a standard process is followed, it isn't as rigid as adjudication process and same can be held towards insolvency proceedings too, though it is codified the tribunals can deviate from the process as long as it doesn't go against the principles of natural justice and equity.

The article by Mark Addison titled "10 reasons why insolvency practitioners should consider ADR" enlightened the researcher on the significance of incorporating ADR mechanisms in insolvency bankruptcy proceedings. It proposes promoting the use of ADR to achieve efficient proceedings and increase the likelihood of positive outcomes within a shorter time frame.

Research Objective

- To understand and analyze the alternate dispute models used for insolvency disputes.
- To understand principles of insolvency law and how ADR is beneficial to it.

- To understand the perceptions of all the stakeholders involved in the insolvency proceedings.
- To understand how ADR mechanism saves time and resources for all the parties involved in an insolvency proceeding.

Research Problem

Insolvency proceedings under the present provisions of law before a tribunal is resource hungry, that consumes time and money of all the stakeholders involved and leaves a bitter taste on the all parties. The adjudication process also doesn't always consider the interests of stakeholders and point of view is restricted only towards safeguarding interests of a shareholder, which causes loss to other parties involved and their dues are not recovered.

Research Question

- Who are the stakeholders involved in insolvency proceedings?
- What is the difference between a court adjudication and ADR mechanism and which process is beneficial?
- What are the principles of bankruptcy law governing insolvency proceedings?

Hypothesis

Alternative dispute resolution is a process alternative to the Civil Procedure Code for a speedy redressal of issues and in the insolvency proceedings, where the company is bankrupt and the stakeholders involved in the company are claiming for repayment of dues owed to them, the best way to reconcile would be to choose the path of ADR as it would save the time, money and resources for the company and also the interests of all the stakeholders involved would be given equal importance before arriving at a mutual settlement. Hence, ADR can be a better tailored suit than the adjudication process before a court, in the present judicial system.

The Article

Insolvency and bankruptcy in India did not have a separate legislation governing them until 2016, they were governed under Companies Act of 2013 and SARFAESI Act of 2022. The Companies Act provided for winding up of companies and the SARFAESI Act provided for the discharge of liabilities towards a secured creditor. But all these legislations did not provide security for creditors hence, the dues owed to the creditors most of the time were not recoverable hence, the government introduced Insolvency and Bankruptcy Bill, which was enacted in the year 2016. The main reason for enacting

the bankruptcy bill was the losses of the creditors were of such an extent that it hampered the economy of the country, hence to reduce the losses and to stabilize the economy the government introduced the act[2].

Bankruptcy disputes are about money. When a debtor gets into financial difficulties, creditors want their debts paid off, Insolvency proceedings are opened and creditors compete for the finite pool of assets (equity) that is rarely enough to pay every stakeholder. Consequently, the debtor is liquidated, which means the end of business, jobs and tax payments. The settlement of insolvency disputes was reserved for the courts for a long time, because the court decision guarantees equal rights for all the creditors, the fair collection and distribution of the debtor's assets and the timely settlement of the insolvency. However, this perception has changed in recent times, Indian judiciary is exploring much more unconventional methods to solve the problems and as more bankruptcy disputes have been resolved not only through court decisions but also through ADR worldwide and Indian judiciary has acknowledged its importance and has introduced it as one of the

[2] Ashitha, *Insolvency and bankruptcy Code*, ASC, (last accessed 1st Dec 2022), https://www.ascgroup.in/possibility-of-using-adr-for-insolvency-resolution-process/

methods while resolving bankruptcy disputes. In general, the legislature chooses a creditor-friendly insolvency regime. Alternate Dispute Resolution encourages the parties to a dispute to reach an agreement through negotiations, mediations and avoid a court decision. This saves time and money for the stakeholders involved.

Evolution of ADR in Bankruptcy Proceedings

ADR in bankruptcy cases hails from the USA, in response to the increase in civil litigation and the socioeconomic changes taking place, mediation was first used in the 1960s to resolve community and family disputes. The emergence of ADR gained significant momentum following the Pound conference, where Harvard professor Sander proposed the concept of a "multi-door court" and encouraged the exploration of alternative methods for resolving disputes. This led to the introduction of mediation in 1986 at the Bankruptcy Court of the South for bankruptcy cases. Subsequently, in the United States, mediation was utilized during the Greyhound Lines bankruptcy, where thousands of creditors were stranded. A pre-restructuring mediation plan was established for the numerous plaintiffs who had made claims for personal injury and property damage against Greyhound in relation to traffic accidents involving

the company's vehicles. This event served as a catalyst in the adoption of mediation as a means of resolving disputes arising from insolvency proceedings. This case serves as a notable example of a multi-party dispute resolution, wherein the debtor is dealt with on an individual basis by each creditor.

In view of the successful examples of ADR, the increasing number of insolvency cases and the rising legal costs, a legal regulation for ADR was created. A major legislative move toward the use of ADR in bankruptcy cases was the passage of the Alternative Dispute Resolution Act of 1998, which required every federal district court to approve ADR in all civil cases including bankruptcy disputes. Today, 60% of the cases choose the ADR method for bankruptcy proceedings[3].

Difference and advantages of ADR over Adjudication before court

[3] Bazul, *Alternative dispute resolution in insolvency and restructuring proceedings,* Lexologoy, (last Accessed 1st Dec 2022) https://www.lexology.com/commentary/insolvency-restructuring/singapore/oon-bazul-llp/alternative-dispute-resolution-in-insolvency-and-restructuring-proceedings

ADR is different from the court process. It is essentially a mechanism for resolving disputes with the aid of a third party, without resorting to the judiciary. There are different forms of ADR, but the intervention of a third party like an arbitrator, mediator or negotiator is often essential. The success of ADR mainly depends on the negotiating skills and the good will of the parties. This is in contrast to jurisprudence where the court leads. Litigants must comply with strict procedural laws that can hamper the creativity and effectiveness of dispute resolution. ADR increases the likelihood of a win-win scenario and reduces the likelihood of a loss to all the parties involved, with ADR, both parties satisfy their main claims through reduction claims to some extent. ADR is based on negotiations between the parties overseen by a third party. Negotiation facilitates the separation of people from the problem, and allows for the circumvention of any legal constraints even if a mutually acceptable solution to the problem is not achieved. Unfortunately, the case law is based on a "win/lose" paradigm, which means that in the end one party loses the case. This can destroy business relationships and trust between trading partners. Sometimes a court decision not only leads to financial but also psychological exhaustion of the parties. Second, in some cases, the ultimate resolution of the dispute is not the primary goal. ADR is often not binding on the parties as neither the mediator

nor the parties are empowered to resolve the dispute. Some of the legal jurists believe that ADR promotes resolution of the dispute rather than reaching a final resolution. ADR allows the parties to evaluate their positions and consider the final settlement of the dispute in the future even if the mediation does not reach an agreement immediately, changing the attitudes of the parties regarding their own positions can lead to an agreement in the future.

ADR encourages the parties to negotiate and find an amicable solution. When making a decision, one should have a final and issue binding decision. In any case, if bankruptcy proceedings are initiated, this usually leads to liquidation of the debtor and triggers the unsolvable problem of the common fund. ADR preserves a "normal" relationship between the parties. It is generally a private rather than a public process, so the parties can avoid making the dispute public. This is a particularly valuable incentive in business relationships (protection of trade secrets and other relevant information). Rather, all disputes that require a decision become public and the court must usually allow public access to the proceedings[4].

[4]Lucy Mcnam, *ADR and its uses in Insolvency proceedings*, Broodies, (last accessed on 2nd Dec 2022), https://brodies.com/insights/restructuring-and-insolvency/alternative-dispute-resolution-and-its-uses-in-insolvency/

ADR is flexible as it allows parties to reach agreement through persuasion and encourages party driven solutions. The parties can decide on the procedural and substantive rules of dispute resolution in insolvency cases. The parties involved in bankruptcy proceedings are bound by stringent procedural regulations, which offer room for exceptions. These regulations can impede the efficiency of the dispute resolution process. Adopting an ADR mechanism can help overcome some of the inherent deficiencies associated with arbitral awards in bankruptcy disputes. This is valuable as the debtor's assets are not wasted on litigation, trustee salaries and other expenses.

The opening of insolvency proceedings reveals the tense financial situation of the debtor and hinders business operations. ADR offers strong incentives for both parties to engage in quick and efficient dispute resolution and seek a joint business solution.

Disadvantages of ADR methods

While ADR methods can offer several benefits in insolvency and bankruptcy proceedings in India, there are also some disadvantages to consider. The main disadvantage of the Mediation is its flexibility and non-binding nature of the process. The parties do not have to reach an agreement during mediation and therefore the whole process

can be rejected by one person, this leads to lost time and money. Disclosure issues also need to be addressed, wherein unlike an arbitration or a court proceeding, it is not possible to compel the other party to disclose all relevant information prior to a mediation, which, maybe crucial for correctly determining the chances of determining an illegal commercial transaction.

On the other hand, there can be an imbalance of power between stakeholders, which can make it challenging to achieve a fair outcome through ADR. For example, creditors may have more bargaining power than debtors, which could result in an unfair outcome. Moreover, the lack of standardization and regulation of ADR processes in insolvency proceedings can also pose challenges. This could lead to inconsistency and unpredictability in the resolution of disputes, and potentially undermine confidence in the ADR process.

Insolvency proceedings and ADR mechanism

It is essential to understand the nexus between insolvency proceedings and alternative dispute resolution methods, the Act was enacted by Parliament to allow the bankruptcy resolution process to be completed in a limited time unlike usual court proceedings. The

company law tribunal will be given 14 days to consider the matter and decide whether to accept or reject it. The NCLT (National Company Law Tribunal) cannot immediately ignore or deny the party's request. It must review the application expeditiously and give the applicant 7 days to correct any remaining deficiencies in the application submitted by the applicant. However, NCLT has many cases to deal with and bankruptcy proceedings are quite complicated affairs and many debtors or business owners believe that bankruptcy proceedings can seriously damage the image and reputation of the company and business owners. Therefore, it is advisable that when conducting a bankruptcy resolution procedure, the parties prefer ADR to the court decision as the privacy of the matter can be controlled and this certainly cannot happen if the matter continues before the Court of Justice[5].

It is very important to understand at what stage the parties to a bankruptcy resolution proceeding should refer the matter to ADR to initiate bankruptcy resolution proceedings. The parties may bring the matter while operating outside the bankruptcy regime. This means

[5] Aishwarya Sethi*, The Scope of Introducing ADR in India's Personal Insolvency Regime*, Kanooniyat, (last accessed on 4th Dec 2022) https://kanooniyat.com/2020/06/the-scope-of-introducing-adr-in-indias-personal-insolvency-regime/

that the parties could manage or reduce the debt and the debtor or debtors could sit down with their creditors and discuss how they would pay off the debt. This can be seen as a technique that could be started before bankruptcy proceedings are opened.

Recent Trends

It is imperative to understand that bankruptcy law in India today focuses on giving a boost to debt recovery rather than debtor rehabilitation, which simply means that the debtor can continue in business. The preamble to the Insolvency and Bankruptcy Code 2016 focuses largely on the reorganization and reorganization of legal entities, which must occur within a specific time frame and follow debt recovery measures. However, if disputes are referred to ADR, then it would also focus on the intricate details of each debtor and each creditor and would also reduce the burden imposed on the NCLT. Hon'ble Judge Sikri suggested that it is vital that mediation be included as a means of dealing with the insolvency proceedings. He also reiterated that the desired time, as provided for in the IBC, 2016, for initiating and resolving insolvency proceedings, including the time required for extensions, is 270 days (Mondal). However, the

matter is rarely resolved all at once and hence ADR is the best economical and time efficient way to safeguard all the interest of the stakeholders' involved ADR has been a boon to the insolvency proceedings and the researcher feels more and more companies are exploring it for a smooth exit from the economy[6].

Conclusion

ADR can be used to facilitate the collective resolution of multiple creditors' claims against the debtor through multi-party negotiations. In such a scenario, ADR could take place at the initiative of the creditors committee and the insolvency administrator. As mentioned above, this would assist in the development of a holistic resolution plan, taking into account the common interests of all stakeholders, because the IBC is a new Law which is still at its incumbency stage and ADR is still in its budding stage in the country. Also, court-ordered mediation on a case-by-case basis is more appropriate for all types of disputes than mandatory pre-trial mediation in cases. In this

[6] Shravani, *Insolvency Mediation in India*, Ex Curia, (last accessed on 5th Dec 2022), http://excuriainternational.com/2020/07/31/insolvency-mediation-in-india-a-stone-unturned/

context, judicial guidelines for activating insolvency mediation must be developed. These guidelines should address the court's referral of bankruptcy cases to mediation under the Code. It can be developed according to specified criteria such as income, assets and debts.

The Indian bankruptcy law can be made more efficient and effective by introducing a temporary mediation process that focuses on debt negotiations and settlements. This will help in building a strong and sustainable debt regime. The use of ADR methods in insolvency and bankruptcy proceedings can provide several benefits, including faster resolution of disputes, reduced costs, and a more equitable outcome for all parties involved. It is essential to develop a comprehensive ADR mechanism that considers the specific circumstances of each case and balances the interests of all stakeholders. This can be achieved by developing clear judicial guidelines that address the referral of bankruptcy cases to mediation under the Code. The guidelines should take into account factors such as income, assets, and debts when determining the suitability of a case for mediation. Moreover, ADR can be initiated by the creditors committee and the insolvency administrator to facilitate the collective resolution of multiple creditors claims against the debtor through multi-party negotiations. This approach can help in developing a holistic

resolution plan that considers the common interests of all stakeholders. ADR can be an effective and efficient mechanism for insolvency and bankruptcy proceedings in India, provided that a comprehensive and balanced approach is adopted. By developing clear guidelines and promoting the use of ADR methods, the bankruptcy law in India can be reformed to build a more robust and sustainable debt regime, which benefits all parties involved in the process.

Suggestion

Although the need to involve alternative ways for solving a legal issue has been recognized in India, no effort has been made to formalize and codify them. The implementation of such a system can also be slow due to the fact that the Indian ADR regime is not yet fully developed, especially in terms of negotiation and mediation. Following uncodified and untested practice cannot work in an ideal world and this leads to ambiguity and arbitrariness, resulting in only few individuals benefiting from such methods. Hence, it is important for the judiciary to take initiative and refer the Insolvency matters to ADR on its own suo-moto to cut down the lengthy adjudication process, thereby providing equity to all the parties involved.