
ANALYSIS OF SWISS RIBBONS (P) LTD. AND ORS. VS UNION OF INDIA (2019) SCC ONLINE SC 73

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INTRODUCTION

Swiss Ribbons (P) Ltd. And Ors. Vs Union of India is a landmark judgement decided on 25th January 2019 which deals with the constitutional validity of many provisions of the Insolvency and Bankruptcy Code, 2016. As the Insolvency and Bankruptcy code is recent and completely new in the field it had many problems and loopholes. This act has been continuously amended many times from the date of its enactment. The judgement focuses on the legality of the various provisions of the Insolvency and Bankruptcy Code rather than the case's facts. The Hon'ble Supreme Court of India received a Special Leave Petition under Article 136, with a batch of ten writ petitions, challenging the constitutional validity of the IBC. In that petition, Swiss Ribbons contended that sec 7,12a,29a,53 of the IBC does not comply with the constitution of India and is violative of Article 14.

The main issues of the case are:-

- 1) Whether the appointment of members of NCLT and NCLAT was in contradiction with the judgment of the Madras Bar Association.
- 2) Whether the classification of financial creditors and operational creditors is violative of Article 14.
- 3) Whether Section 12 A of the code is Constitutional and whether section
- 4) 29A of the Code is constitutional as the vested rights of erstwhile promoters to participate in the recovery process of a corporate debtor have been impaired by retrospective application of Section 29A?
- 5) Whether section 53 of the Code is Constitutional?¹

Issue 1

¹ Swiss Ribbons Pvt. Ltd. v Union of India (2019) SCC Online SC 73.

In the first issue, NCLT and NCLAT did not get their members appointed in a way that was consistent with the Constitution. Two members were judges, while the remaining three were bureaucrats. And the Ministry of Corporate Affairs provides all the necessary administrative assistance. The Supreme Court upheld the constitutionality of the Companies (Amendment) Act, 2017, which stipulates that the National Company Law Tribunal and the National Company Law Appellate Tribunal must each have two judicial members and two executive members. The Supreme Court ruled that the Ministry of Corporate Affairs' funding of the National Company Law Tribunal and the National Company Law Appellate Tribunal is constitutional.

The appellant also argued for the establishment of circuit benches. Before, they had an opportunity to present their case to the High Court in their respective States prior to the establishment of NCLT and NCLAT, but this is no longer possible since NCLT has its sole seat in New Delhi. In *Madras Bar Association v. Union of India*,² the issue before the court is the establishment of the National Company Law Tribunal and National Company Law Appellate Tribunal. NCLAT was established only in Delhi and for any appeal from NCLT, one cannot go to High Court as NCLAT was established. And the court held that expecting aggrieved parties to travel to exercise their right to appeal is both impractical and unfair. Since people from all over the country would have to make the long journey to New Delhi just to use one bench, this would be defeating the object of the act as it is time consuming. The Supreme Court, citing earlier precedent, ordered the Union to set up circuit benches within six months of the judgement.

Issue 2

Under IBC classification of financial creditor and operational creditor has been made under section 7 of the code. These two creditors are classified based on the type of debt. Financial creditors are those who lend money by way of cash or cash equivalents like cheques, DD, etc. whereas operational creditors are those who are engaged in the operation of the business like they will provide services or goods to the operation of the business.

The petitioner primarily argued that a clear distinction cannot be drawn between financial creditors and operational creditors the petitioners argued that making such a difference is unlawful because it does not exist anywhere else in the globe. Such a distinction is

² (2015) 8 SCC 583.

unconstitutional and violative of article 14. In order to start the settlement process, the committee of creditors should approve with 90% of the voting rights as per section 12 of the Insolvency and Bankruptcy Code. In such an important committee like COC, the operational creditor cannot exercise his voting rights which is a violation of article 14 of the Indian constitution. The court held that there is no disparity, arbitrariness or violation the Art 14 of the constitution due to the difference made within the creditors. The court's reasoning was that the financial creditor needs to know more about the corporate debtor's business and financial stability before extending a large loan.

Issue 3

In this, the constitutionality of article 12a of IBC was in question. According to sec 12 (CIRP) application under Section 12A if the Committee of Creditors agrees with the withdrawal by a majority vote of 90%. Once an insolvency application is admitted by the court, the corporate debtor previously had two options for satisfying creditors and stakeholders: either continue the sale of the business in whole or in part, or wind up and liquidate the assets of the company. This changed with the addition of section 12A to the Insolvency and bankruptcy code. The court viewed that once an insolvency application is admitted, the Corporate Insolvency resolution process is considered "in-rem," and it is not an individual proceeding but a collective proceeding. the Supreme Court elaborated that all parties, not just the corporate debtor, have a vested interest in the outcome of the case. In some cases, settlements have been approved, but only between the company and its creditors.

Issue 4

Section 29a was also challenged by the petitioners which is prospective in nature. From its commencement, the Code has been subject to constant judicial oversight, with many different types of cases indicating that changes are necessary. Resolution applicant's substantial disqualifications were added to the Code in Section 29A in November 2017. A resolution applicant cannot be a person who is ineligible to operate as a director or a wilful defaulter under the provisions of the RBI Regulation Act, 1949 or who is an undischarged insolvent. It was contended that since Section 29A can be applied retroactively, it undermines the rights of former promoters to take part in the recovery process, which in turn causes the growth of pending litigations and makes it time consuming resolution process. It would be unfair to prohibit promoters of the corporate defaulter from serving as resolution applicants without providing an exception for efficient promoters. It is completely irrational to prohibit former

promoters' family members from participating in the company under Section 29A(j), even if they had no real involvement in running the company.

The supreme court referred to a judgement of *Arcelor Mittal India Pvt. Ltd. v. Satish Kumar Gupta and Ors.*³ where it was determined that the resolution petitioners were not qualified to submit section 29A (c) resolution plans. Therefore, the rights they were already afforded were unaffected by the retrospective application of Section 29A of the IBC. A statute cannot be considered to prohibit retrospective if it modifies pre existing rights or if some of the criteria for its effect are drawn from a time period before its implementation. The court did not accept the argument made by the petitioner.

Issue 5

This is another important issue raised by the petitioner in which section 53 was challenged to state constitutionally invalid. Sec 53 of the IBC gives priority to the financial creditor compared to the operational creditor. Financial creditors are first given their money compared to the operational creditor at the time of asset distribution. This giving priority between each other is violative of article 14 of the constitution. Sec 53 of the IBC laid down a structure in which the assets are to be distributed. Financial creditors are put in the top and the operational creditors are brought down the structure and placed below the unsecured creditors.

The Supreme Court noted that when thinking about the goal of the Code, the difference among secured debts like mortgages and unsecured debts is crucial. The Court went on to say that debt repayment spreads capital throughout the economy by allowing banks and other financial institutions to lend that money to other businesses and entrepreneurs. The categorization of creditors for the distribution of assets is thus given a genuine and legitimate basis. Workmen's dues are a form of unsecured debt, and as such, they are prioritised over other forms of debt in the same category. Since the classification made has a rational relationship to the goal sought to be attained by this Code, an understandable differentia can be established. Hence article 14 is not been violated.

Analysis and Conclusion

In this case, the Supreme court upheld the constitutional validity of the Insolvency and Bankruptcy code. This judgement has gone deep into the provision of the act while making this

³ Civil Appeal Nos 9402-9405 of 2018.

judgement. This judgement act as a precedent and in many cases this has been cited.

I agree with most parts of the judgement I also have a different view with the judgement pronounced like in the section there is a difference between the operational and financial creditor. The operational and financial creditors have different procedures to start a corporate insolvency resolution process (CIRP). During the time of the judgement, no operational creditors were allowed with a voting right in the committee of creditors (COC) which is the most important committee which is responsible for taking all decisions after the company started the insolvency process started. The operational creditor is allowed to attend the meeting of the COC only when there is no financial creditor for the corporate debtor. Even for the participation of the operational creditor in the Committee of creditors, the operational creditor must have at least ten per cent in the total debt of the corporate debtor. If the operational creditor does have not ten per cent, then not only they will be able to vote but also cannot attend the meeting itself.

The rationale given behind this decision is that the court viewed that the financial creditors will always have more debt compared to operational creditor and repayment of financial debt allow the money to flow into the economy and many banks and other financial institutions will encouraged to lend more and again to the company for the development. This view might be partially true but in a company of a large scale, operational creditors play an important role and give their services and goods to the corporate debtor. The monetary value of such services and goods like heavy machinery of large quantity will be very high. If the operational creditors are not given as importance as the financial creditors then it will reduce the confidence of the operational creditor which will limit the amount of debt given to the corporate debtor which would result in slow growth of the company.

In Committee of creditors of Essar Steel India Limited v. Satish Kumar Gupta⁴ which is a landmark case which gave a contradicting view on the judgement of Swiss Ribbons. In this case, it held was that there should be no difference between the operational creditor and the financial creditor. Both operational and financial creditors should be given the same level of importance. Another important aspect of the judgement is that now the committee of creditors does not have the power to discuss the claims of creditors.⁵

⁴ [2019] SC 07

⁵ Chinmoy Pradip Sharma, Essar Steel Judgment: IBC undergoes much needed course correction, Bar and Bench, 2019. Available at: [Essar Steel Judgment: IBC undergoes much needed course correction \(barandbench.com\)](https://barandbench.com). Accessed on: 09/10/2022.

Shortly after this judgement, there was an amendment made to the act in 2019 which was passed by the parliament. By this amendment, the Essar Steel Judgement was overlooked and financial creditor rights were restored. In this amendment sec 30(2)(b) sets a minimum limit for the operational creditors. Now the operational creditor will receive a larger amount during the time of asset distribution while liquidation. Also, this amendment gave the power to the committee of creditors to take decisions regarding the distribution of funds which earlier was restricted by the judgement of Essar Steel.