CONSTITUTIONALITY OF THE INSOLVENCY & BANKRUPTCY CODE, 2016: A CASE COMMENT ON SWISS RIBBONS PVT. LTD. & ANR. V. UNION OF INDIA & ORS

Anna Biju, B. Com LLB. (Hons), His Highness Maharajas Government Law College, Ernakulam, Kerala

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ABSTRACT

The Insolvency and Bankruptcy Code, 2016, popularly known as the IBC Code, is a comprehensive legislation which deals with insolvency and bankruptcy proceedings and, in the larger sense, deals with the economy of the country as whole. It was introduced to piece together the fragmented legislative framework which was in place prior to this. However, it was subject to numerous challenges regarding its constitutionality since its inception. In this writ petition to the Supreme Court of India, the IBC Code was made subject to the test of constitutionality. This case comment briefly discusses the background of the case, the core issues that were raised, the assessment and legal analysis of the issues, and finally the judgment of the court. By the judgment of this case, the court upheld the constitutional validity of the Code while suggesting few technical corrections to be made. This judgment could be considered as finality to the Code, silencing the issues that were continually raised ever since the Code came into force, with respect to the constitutionality of the provisions of the Code.

INTRODUCTION & BACKGROUND

Swiss Ribbons Pvt. Ltd. & Anr. v. Union of India, (2019)4 SCC 17, was brought before the Hon'ble Supreme Court of India in 2018 by way of ten writ petitions and a special leave petition, the signature petition being writ petition No:99 of 2018. The case revolved around the constitutionality of the Insolvency & Bankruptcy Code of 2016.

The Insolvency & Bankruptcy Code of 2016, popularly known as the IBC CODE, 2016, is an extensive legislative framework which deals with all matters related to insolvency and bankruptcy. It sought to revamp the entire debt recovery structure of the Indian economy while balancing the interests of the stakeholders.

This legislation was challenged on the ground that several provisions in the Code violated Article 14 of the Constitution of India and that it did not pass the test of constitutionality.

ISSUES RAISED

1) Whether the appointment of members to the National Company Law Tribunal (NCLT) and National Company Law Appellate Tribunal (NCLAT) were in consonance with the court's order in a precedent case[1].
2) Whether administrative support could be provided to the NCLT & NCLAT by the Ministry of Corporate Affairs (MCA).[2]
3) Whether the classification of creditors into financial creditors and operational creditors under Sections 7 – 9, was reasonable.
4) Whether the representation of operational creditors in the Committee of Creditors (CoC) under Sections 21, 24, & 12A was adequate.
5) Whether the vested rights of the erstwhile promoters to participate in the recovery process of a corporate debtor have been impaired by Section 29A.
6) Whether the differential ranking of financial creditors and operational creditors under Section 53, for the distribution of assets after liquidation was reasonable.

ASSESSMENT AND LEGAL ANALYSIS

The submissions for the petitioner were made by Shri Mukul Rohtagi, learned Senior Advocate, and as against these submissions, they were countered by Shri K. K. Venugopal, the learned

[1] Madras Bar Association v. Union of India, (2015) 8 SCC 583
[2] Madras Bar Association v. Union of India, (2015) 8 SCC 583

Attorney General for India, and Shri Tushar Mehta, learned Solicitor General for India, appearing for the Union of India, and Shri Rakesh Dwivedi, learned Senior Advocate, appearing for the Reserve Bank of India.

ISSUE 1)

With respect to the appointment of members to the NCLT & NCLAT, the petitioners claimed that it was contrary to what was directed by the court in the precedent case as a result of which, the two Judicial Members of the Selection Committee get outweighed by three bureaucrats.

However on analyzing the facts, the court concluded that when the Companies Act was amended and the Companies Act, 2017 was introduced, new provisions in consonance with the direction of the court was provided for as under Section 412, and thus the submission in itself was factually incorrect.

ISSUE 2)

The petitioners argued that having the MCA give administrative support to NCLT & NCLAT was a clear violation of the judgment of the court in the same precedent case, wherein the court had held that the administrative support to all tribunals must only be provided by the Ministry of Law & Justice, and not by any other ministry.

The court agreed with the petitioners and directed the union to follow the judgment of the court, in both letter and spirit.

ISSUE 3)

This was the core issue that was raised by the petitioners. They submitted that the classification of creditors into two different groups, namely – financial creditors and operational creditors, was not reasonable and that since there was no clear distinction between the two, there was no intelligible differentia, thus making the classification discriminatory and manifestly arbitrary[3], and violative of Article 14.

However on the perusal of Sections 7 – 9 of the Code, a clear distinction was established between the two classes of creditors, the distinction being the fact that financial creditors are secured creditors, which includes large financial lending institutions such as banks, who provides long term loans to corporate firms for meeting their working capital requirements,

[3] Shayara Bano v. Union of India, (2017) 9 SCC 1

while operational creditors are unsecured creditors who are basically suppliers, who lends small sums of money on a recurring basis. The respondents thus successfully established an intelligible differentia.

Moving on, it was established on the basis of various reports of various committees[4] that such distinction was necessary to trigger the Code, and to revise the debt recovery structure of the Indian economy whereby the Code sought to maximize the debt recovery of creditors, being the objective sought to be achieved by the Code.

The court on evaluation, upheld the classification and held that the classification being reasonable was not violative of article 14.

ISSUE 4)

In the beginning, where any creditor institutes a Corporate Insolvency Resolution Process (CIRP), the interim resolution professional shall under Section 21 constitute a Committee of Creditors (CoC), which shall comprise all financial creditors of the corporate debtor, but not any operational creditor. Later, operational creditors were allowed representation in the CoC, but only to the extent of their financial debts, which was fixed to be not less than ten per cent of the owed debt, as under Section 24. The petitioners argued that these provisions expressly reveal the manifest discriminatory treatment against operational creditors.

However, the respondents, on the basis of the BLRC Report, established that since the financial creditors are in the business of money lending, banks and financial institutions are best equipped to assess viability and feasibility of the business of the corporate debtor. Furthermore, at the time of granting loans, these institutions conduct an elaborate market study. Since this detailed study has already been undertaken before sanctioning a loan, and since financial creditors are better equipped to assess viability and feasibility, they are on an advantageous ground to evaluate a resolution plan. On the other hand, operational creditors, who are engaged in the supply of goods and services, are solely concerned in recouping the payment for such goods and services, and are ordinarily inept to appraise the viability and feasibility of a business.This was also upheld by the court.

Further, as per Section 12A, the CoC may allow the withdrawal of an application admitted under Section 7 - 10, with the approval of ninety per cent voting share of the CoC. This high

[4] BLRC Report

threshold was challenged by the petitioners on the ground that it would lead to arbitrary decisions, as the ninety per cent is substantially all the financial creditors and on the further ground that it was contrary to a former judgment of the court[5].

However the court stated that once a CIRP was instituted, it becomes a collective proceeding, with all the creditors on one side, and the corporate debtor on the other. Moreover, it was made clear that, the CoC do not have the last word on the subject, as under Section 60 of the Code, if the CoC arbitrarily dismisses an equitable settlement or a claim for withdrawal, the NCLT, and thereafter, the NCLAT can be moved to set aside any such decision. For all these reasons, the court upheld the constitutionality of the provisions in issue.

ISSUE 5)

Once a company commence the process of resolution, applications would be invited with respect to the potential resolution proposals to the extent to which the company or the enterprise is concerned. Section 29A introduces those who are not eligible to apply which specifically includes the erstwhile promoters of the corporate debtor.

The petitioners challenged this blanket ban on all promoters of corporate debtors, without any mechanism to weed out those who are unscrupulous and have brought the company to the ground, as against persons who are efficient managers, but who have not been able to pay their debts due to various other reasons, would not only be manifestly arbitrary, but also be treating unequal as equals.

It was further argued that 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.

As against the former argument, the respondents brought to the attention of the court yet another former judgments[6], wherein the court had observed that the Parliament had introduced Section 29A into the Code with a specific purpose which was to ensure that among others, persons responsible for insolvency of the corporate debtor do not participate in the resolution process.

[5] Uttara Foods & Feeds Pvt. Ltd. v. Mona Pharmachem, Civil Appeal No. 18520/2017
[6] Chitra Sharma v. Union of India, Writ Petition (Civil) No. 744 of 2017

Following the aforesaid judgment, the Court stated that Section 29A has been enacted in the larger public interest and to facilitate effective corporate governance.

As against the latter argument, the court adhered to one of its former judgment[7], wherein it was already held that resolution applicants have no vested right to be considered as such in the resolution process.

ISSUE 6)

Section 53 deals with distribution of assets after liquidation, and accordingly in the event of liquidation, operational creditors are ranked below all other creditors. This was argued by the petitioners to be discriminatory and manifestly arbitrary and thus, violative of Article 14.

The court relying upon the BLRC Report held that such differential ranking was necessary, for in the long run this would increase the availability of finance, reduce the cost of capital, promote entrepreneurship and lead to faster economic growth. The government also will be the beneficiary of this process as economic growth will increase revenues. It would ultimately help to achieve the object sought to be achieved by the Code, which was to put the economy back into its rightful position.

JUDGMENT

The judgment was passed by the Hon'ble Supreme Court on 25th January, 2019 by Justice R Nariman. The court noted that in the working of the Code, the flow of financial resources to the commercial sector in India has increased exponentially as a result of financial debts being repaid. The court reinforced the constitutional validity of the Code.

Concluding the judgment, Justice Nariman highlighted the IBC Code, 2016 as an economic, legislative experiment that successfully passed the constitutional muster, putting the economy back into its rightful position, and depriving the defaulters of a paradise that was available before the Code.

CONCLUSION

The Supreme Court in its judgment assumed a wider stance to uphold and validate the constitutionality of the IBC Code, 2016. By prioritizing financial creditors over other unsecured creditors, the Code takes a step further towards achieving the objective of the Code-

[7] Arcelormittal India Pvt. Ltd. V. Satish Kumar Gupta & Ors, Civil Appeal Nos. 9402- 9405/2018

"putting the economy back in its rightful position". By pointing out the intelligible differentia between financial and operational creditors, the Code ensures the preservation of the intent of the economic legislation.

The Code, in addition to providing a mechanism to the defaulter to revive, ensures a fair and efficient procedure to facilitate it. Preserving the interests of all stakeholders is one of the objectives of the Code and the judgment only affirms it. On passing the test of constitutionality, the Code can be referred to as a 'beneficial legislation' relating to economic matters.