

Insolvency and Bankruptcy Board of India
7th Floor, Mayur Bhawan, Connaught Place, New Delhi - 110001.

25th January, 2019

Subject: Judgement¹ dated 25th January, 2019 of the Hon'ble Supreme Court of India in the matter of Swiss Ribbons Pvt. Ltd. & Anr. Vs. Union of India & Ors. [WP (Civil) Nos. 99, 100, 115, 459, 598, 775, 822, 849, and 1221 of 2018, SLP (Civil) No. 28623 of 2018 and WP (Civil) 37 of 2019]

Several petitions were filed assailing the constitutional validity of various provisions of the Insolvency and Bankruptcy Code, 2016 (Code). While dismissing these petitions, the Hon'ble Supreme Court made several important findings and rulings as under:

Sl. No.	Issue / Theme	Ruling	Para / Page No.
1	The preamble of the Code.	<p>a. The Code is for reorganization and insolvency resolution of corporate debtors (CD) in a time-bound manner.</p> <p>b. The Code maximises the value of the assets of CDs.</p> <p>c. The Code promotes entrepreneurship as the persons in management of the CD are replaced by entrepreneurs.</p> <p>d. As resolution plan takes off, the CD is able to repay its debts, which promotes credit market.</p> <p>e. As the CD benefits from the resolution, the interests of all stakeholders are looked after.</p> <p>f. The Preamble does not, in any manner, refer to liquidation, which is only availed of as a last resort if there is either no resolution plan or the resolution plans submitted are not up to the mark.</p> <p>g. Even in liquidation, the liquidator can sell the business of the CD as a going concern.</p>	11 / 37
2	The approach of the Code	<p>a. The Code ensures revival and continuation of the CD by protecting it from its own management and from liquidation.</p> <p>b. The Code is a beneficial legislation which puts the CD back on its feet, not being a mere recovery legislation for creditors.</p> <p>c. The Code bifurcates and separates the interests of the CD from that of its promoters / management.</p> <p>d. The resolution process is not adversarial to the CD but, in fact, protective of its interests.</p> <p>e. The moratorium imposed by section 14 is in the interest of the CD itself, thereby preserving the assets of the CD during the resolution process.</p>	12 / 39

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		f. The timelines within which the resolution process is to take place protects the CD's assets from further dilution, and also protects all its creditors and workers.	
3	About NCLT and NCLAT	a. The appointment of members of these tribunals have been regularly appointed. b. Administrative support for these tribunals needs to come from the Ministry of Law and Justice. c. Union of India shall set up Circuit Benches of the NCLAT within a period of 6 months from today.	16 - 17 / 43 - 44
4	Classification into financial creditors (FCs) and operational creditors (OCs).	a. Most FCs are secured creditors, whereas most OCs are unsecured. b. Nature of loan agreements with FCs is different from contracts with OCs for supplying goods or services. c. FCs generally lend finance on a term loan or for working capital that enables the CD to either set up and/or operate its business. On the other hand, contracts with OCs are relatable to supply of goods and services in the operation of business. d. Financial contracts generally involve large sums of money. Operational contracts have dues whose quantum is generally less. e. In the running of a business, OCs can be many as opposed to FCs, who lend finance for the set up or working of business. f. FCs have specified repayment schedules, and defaults entitle them to recall a loan in totality whereas contracts with OCs do not have any such stipulations. g. There is difference in dispute resolution of FCs and OCs. Contracts with OCs can and do have private arbitration clauses for dispute resolution, whereas, in loan contracts no such facility. h. Operational debts tend to be recurring in nature and possibility of genuine disputes in case of operational debts is much higher when compared to financial debts. i. Goods supplied or services provided by OCs may be substandard or goods may not have been supplied at all. These qua operational debts are matters to be proved in arbitration or in the courts of law. On the other hand, financial debts made to banks and financial institutions are well-documented and defaults made are easily verifiable. j. FCs are from the very beginning involved with assessing the viability of the CD. FCs can, therefore do, engage in restructuring of the loan as well as re-organisation of the CD's business when there is financial stress, which are things OCs do not and cannot do. k. There is an intelligible differentia between the FCs and OCs which has a direct relation to the objects sought to be achieved by the Code. l. Classification between FCs and OCs is neither discriminatory, nor arbitrary, nor violative of Article 14.	27 - 28 / 64 - 66

5	Notice, hearing, set-off or counter claim qua financial debts.	<p>a. The CD is served with a copy of the application filed with the Adjudicating Authority (AA) and has the opportunity to file a reply before the said authority and be heard by the said authority before an order is made admitting the said application. What is also of relevance is that in order to protect the CD from being dragged into the corporate insolvency resolution process <i>malafide</i>, the Code prescribes penalties.</p> <p>b. A set-off of amounts due from financial creditors is a rarity. It may be considered at the stage of filing of proof of claims during the resolution process by the resolution professional, and his decision is subject to challenge under section 60 of the Code.</p> <p>c. There is nothing in the Code which interdicts the CD from pursuing counterclaims in other judicial fora.</p> <p>d. Legislative Policy has shifted from “inability to pay debts” to “determination of default”. There are four reasons for the same: (a) predictability and certainty; (b) interest of CD is to be safeguarded; (c) the cause of default is not relevant and protecting economic interest is relevant in case of financial stress; (d) liquidation can only be upon failure of resolution process.</p> <p>e. “Claim” gives rise to “debt” only when it is “due” and “default” occurs only when “debt” becomes “due and payable” and is not paid by debtor. This is why financial creditor proves default and operational creditor claims a right to payment of liability. When this is kept in mind, the differentiation in triggering of insolvency resolution process by financial and operational creditors becomes clear.</p>	33 – 38 / 73 - 81
6	OCs and Committee of Creditors (CoC)	<p>a. The CoC has the primary responsibility of financial restructuring. It assesses the viability of a CD by taking into account all available information as well as to evaluate all alternative investment opportunities that are available. It evaluates the resolution plan on the basis of feasibility and viability.</p> <p>b. Since the FCs are in the business of money lending, they are best equipped to assess viability and feasibility of the business of the CD. Even at the time of granting loans, they undertake a detailed market study which includes a techno-economic valuation report, evaluation of business, financial projection, etc. They are in a good position to evaluate the contents of a resolution plan.</p> <p>c. On the other hand, OCs, who provide goods and services, are involved only in recovering amounts that are paid for such goods and services, and are typically unable to assess viability and feasibility of business.</p> <p>d. The NCLAT has, while looking into viability and feasibility of resolution plans approved by the CoC, always gone into whether OCs are given roughly the same treatment as FCs, and if they are not, such plans are either rejected or modified so that the OCs’ rights are safeguarded.</p>	43 - 48 / 93 - 97

		<p>e. Regulation 38 of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 strengthens the rights of OCs by statutorily incorporating the principle of fair and equitable dealing of their rights, together with priority in payment over FCs.</p> <p>f. OCs are not discriminated against or Article 14 has not been infringed either on the ground of equals being treated unequally or on the ground of manifest arbitrariness.</p>	
7	Section 12A vis-a-vis Article 14.	<p>a. Regulation 30A(1) of the CIRP Regulations is not mandatory but is directory for the simple reason that on the facts of a given case, an application for withdrawal may be allowed in exceptional cases even after issue of invitation for expression of interest under Regulation 36A.</p> <p>b. After admission of creditor's petition under section 7 to 9 of the Code, the proceeding before the Adjudicating Authority is a proceeding in rem.</p> <p>c. A party can directly approach NCLT for withdrawal or settlement at any stage if the CoC is not constituted which will be decided by the NCLT after hearing all the concerned parties.</p> <p>d. That withdrawal requires approval of CoC by 90% of voting power is in the domain of the legislative policy.</p> <p>e. The CoC does not have the last word on the subject; if CoC arbitrarily rejects a just settlement and/or withdrawal claim, the NCLT can always set aside such decision under section 60 of the Code.</p>	51 – 53 / 100-102
8	Information Utilities	The evidence of default with an Information Utility is only prima facie evidence of default, which is rebuttable by the CD.	57 / 105
9	Powers of Resolution Professional (RP).	<p>a. RP has no adjudicatory powers. He has administrative powers as opposed to quasi-judicial powers.</p> <p>b. The RP is really a facilitator of the resolution process, whose administrative functions are overseen by the CoC and by the AA.</p>	58, 59 & 61 / 105, 108&110
10	Constitutional validity of Section 29A.	<p>a. A statute is not retrospective merely because it affects existing rights; nor is it retrospective merely because a part of the requisites for its action is drawn from a time antecedent to its passing.</p> <p>b. A resolution applicant has no vested right for consideration or approval of its resolution plan and, therefore, no vested right is taken away by Section 29A.</p> <p>c. There is no vested right in an erstwhile promoter of a CD to bid for the immovable and movable property of the CD in liquidation. Section 29A not only applies to resolution applicants but also to liquidation.</p> <p>d. A person, who is unable to service its own debt beyond the grace period, is unfit to be eligible to become a resolution applicant. This policy cannot be found fault with.</p> <p>e. Neither can the period of one year be found fault with, as this is a policy matter decided by the RBI and which emerges from its Master Circular, as during this period, an NPA is classified as a substandard asset.</p>	64 - 80 / 119-142

		<p>f. Persons who act jointly or in concert with others are connected with the business activity of the resolution applicant. All categories of persons mentioned in section 5 (24A) of the Code must be connected with the resolution applicant within the meaning of section 29A (j). The categories of persons who are collectively mentioned as ‘relative’ in explanation to section 5 (24A) need to have a connection with the business activity of the resolution applicant.</p> <p>g. Rationale for excluding MSMEs from eligibility criteria laid down in Section 29A (c) and 29A (h) of the Code is qua such industries, other resolution applicants may not be forthcoming which would not lead to resolution but liquidation.</p>	
11	Addressing hardships arising from and monitoring the working of the Code	<p>a. When the Code has worked hardship to a class of enterprises, the Committee constituted by the Government, in overseeing the working of the Code, has been alive to such problems, and the Government in turn has followed the recommendations of the Committee in enacting Section 240A.</p> <p>b. This is an important instance of how the executive continues to monitor the application of the Code and exempts a class of enterprises from the application of some of its provisions in deserving cases.</p> <p>c. This and other amendments that are repeatedly being made to the Code, and to subordinate legislation made thereunder, based upon Committee Reports which are looking into the working of the Code, would show that the legislature is alive to serious anomalies that arise in the working of the Code and steps in to rectify them.</p> <p>d. The working of the Code is being monitored by the Central Government by Expert Committees that have been set up in this behalf.</p> <p>e. Amendments have been made in the short period in which the Code has operated, both to the Code itself as well as to subordinate legislation made under it. This process is an ongoing process which involves all stakeholders, including the petitioners.</p>	81, & 85 / 144 & 148
12	Section 53 vis-à-vis Article 14	Unsecured debts are of various kinds, and so long as there is some legitimate interest sought to be protected, having relation to the object sought to be achieved by the statute in question, Article 14 does not get infringed. For these reasons, the challenge to Section 53 of the Code must also fail.	84 / 148
13	Constitutional Validity of Code	The experiment contained in the Code, judged by the generality of its provisions and not by so-called crudities and inequities that have been pointed out by the petitioners, passes constitutional muster.	85 / 148
14	Working of the Code	<p>a. The flow of financial resource to the commercial sector in India has increased exponentially as a result of financial debts being repaid.</p> <p>b. These figures show that the experiment conducted in enacting the Code is proving to be largely successful.</p> <p>c. The defaulter’s paradise is lost. In its place, the economy’s rightful position has been regained.</p>	86 / 150