INDIA'S FIRST MAGAZINE ON LEGAL AND CORPORATE AFFAIRS

LEX WITNESS

Volume 10 Issue 6 | January 2019

₹65 US $6 UK £4

2019

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Analysis of The Judgment of The Hon'ble Supreme Court in The Challenge to The Constitutional Validity of Insolvency and Bankruptcy Code, 2016

Sachin Gupta

The Hon'ble Supreme Court today passed a landmark judgment wherein the constitutional validity of the Insolvency and Bankruptcy Code, 2016 was upheld in its entirety. The Hon'ble Supreme Court had made certain observations and the major issues decided in the judgment given by the Bench of Justice Rohinton Nariman and Justice Navin Sinha on 25.01.2019 are as follows:

I. Appointment of members of NCLT and NCLAT not contra to this Court's judgment

The Supreme Court has held that as the selection committee was formed and proper advertisements were issued for inviting application for judicial and technical members and as a result of which all present members of NCLT and NCLAT have been appointed. Thus, the appointment of members is not contra to this Court's judgment in Madras Bar Association.

II. NCLAT Bench only at Delhi

As the Ld. Attorney General assured the Court that the judgment in the matter of Madras Bar Association will be followed and circuit benches will be established soon. The court directed the Union of India to set up circuit benches of the NCLAT within a period of 6 months from today.

III. Tribunals are functioning under the Wrong Ministry

The Supreme Court observed that as per the Constitution Bench judgment in the matter of Madras Bar Association, "the administrative support for all tribunals should be from the Ministry of Law & Justice". The Supreme Court further observed that it is high time that the Union of India follows, both in letter and spirit of the judgment of this Court.

IV. Classification between Financial Creditor and Operational Creditor neither Discriminatory, Nor arbitrary, Nor Violative of Article 14 of the Constitution of India

Supreme Court has observed that the Financial Creditor is from very beginning involved with assessing the viability of the Corporate Debtor. They can engage in the restructuring of the loan as well as the reorganization of the Corporate Debtor's business when there is financial stress which are things Operational Creditors do not and cannot do. Thus, preserving the Corporate Debtor as a going concern, while ensuring maximum recovery for all creditors, Financial Creditors are clearly different from

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Operational Creditors and therefore, there is obviously an intelligible differentia between the two which has a direct relation to the objects sought to be achieved by the Code.

V. Notice, hearing, and set-off or Counterclaim qua Financial Debts

The Supreme Court has observed that in so far as set-off and counterclaim is concerned, a set-off of the amounts due from the Financial Creditors is a rarity. However, legitimate set-off may be considered by the Resolution Professional during the filing of proof of claims. The Supreme Court further observed that a Financial Creditor has to prove default as opposed to an Operational Creditor who merely claims a right to payment of liability or obligation in respect of a debt which may be due. When this aspect is borne in mind, the differentiation in triggering insolvency resolution process by a Financial Creditor under Section 7 and by Operational Creditors under Section 8 and 9 of the Code becomes clear.

VI. Operational Creditors have no vote in Committee of Creditors

The Supreme Court observed that after the modification of Section 24(3) and (4), the Operational Creditors have been given a representation on the Committee of Creditors, however the Supreme Court observed that since the Financial Creditors are in the business of money lending, they are best equipped to asses viability and feasibility for the business of the Corporate Debtor since they have trained employees to assess the viability and feasibility they are in good position to evaluate the contents of a Resolution Plan on the other hand, Operational Creditors who provide goods and services are involved only in recovery of amounts

that are paid for such goods and are typically unable to assess the viability and feasibility of business. For the above reasons, the Supreme Court has held that the Operational Creditors are not discriminative or Article 14 has been infracted either on the ground of equals being treated unequally or on the ground of manifest arbitrariness.

VII. Section 12(A) is not violative of Article 14

The Supreme Court has clarified that where Committee of Creditors is yet not constituted, a party can approach the NCLT directly and the NCLT may exercise its power under Rule 11 of the NCLT Rules and allow or disallow an application for withdrawal of settlement after hearing the concerned parties and considering relevant factors of the case. The Supreme Court has also held that high threshold of 90% is also not arbitrary as all Financial Creditors have to put their heads together to allow such withdrawal as a settlement involving all creditors ought, ideally, to be entered into.

VIII. Evidence provided by Private Information Utilities: Only Prima Facie Evidence of a default

IX. Resolution Professional has no adjudicatory powers

It has been held that the regulations clearly show that the Resolution Professional is given administrative as opposed to quasi-judicial powers. The Resolution Professional is really a facilitator of the resolution process, whose administrative functions are overseen by the Committee of Creditors and by the Adjudicating Authority.

X. Section 29A(c) not restricted to malfeasance

While deciding this, the Supreme Court

has held that given the categories of persons who are ineligible under Section 29A, which includes persons who are malfeasant, or persons who have fallen foul of the law in some way, and persons who are unable to pay their debts in the grace period allowed, are further, by this proviso, interdicted from purchasing assets of the corporate debtor whose debts they have either willfully not paid or have been unable to pay. The legislative purpose which permeates Section 29A continues to permeate the Section when it applies not merely to resolution applications, but to liquidation also.

XI. One year period in Section 29A(c) and NPA

The Supreme Court has held that the legislative policy, is that a person who is unable to service its own debt beyond the grace period referred, is unfit to be eligible to become a resolution applicant. This policy cannot be found fault with. 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. The ineligibility attaches only after this one-year period is over as the NPA now gets classified as a doubtful asset.

XII. Related Party

The expression "related party", and "relative" contained in the definition Sections must be read noscitur a sociis with the categories of persons mentioned in Explanation I, and so read, would include only persons who are connected with the business activity of the resolution applicant.

XIII. Exemption of Micro, Small and Medium Enterprises from Section 29A

The rationale for excluding such industries from the eligibility criteria laid down in Section 29A(c) and 29A(h) is because, qua such industries, other Resolution Applicants may not be forthcoming, which then will inevitably lead not to resolution but liquidation.

XIV. Section 53 of the Code does not violate Article 14

The Supreme Court observed that the repayment of financial debts infused capital into the economy with the money that has been paid back so that the Banks can further lend such money to other entrepreneurs for their business. This rationale creates an intelligible differentia between financial debts and operational debts which are unsecured. In any case, the workmen dues which are also unsecured debts have been placed above most of the other debts. Thus, Article 14 does not get infracted and the challenge to Section 53 fails.

In the end, the Supreme Court has observed that in the working of the Code the flow of financial resource to the commercial sector in India has increased exponentially as a result of financial debt being repaid. Approximately, 3300 cases have been disposed off by the Adjudicating Authority based on out of courts settlement which involved claims amounting to over INR 1,20,390 Crores. 80 cases have been resolved by resolution plans being accepted. Of these 80 cases, the liquidation value of 63 such cases is INR 29788.07 Crores, whereas the amount realized from the resolution process is in the region of INR 60,000 Crores which is over 202% of the liquidation value.

The Defaulters Paradise is Lost. In Its Place, the Economy's Rightful Position has been Regained

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