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SWISS RIBBONS: INDIAN SUPREME COURT UPHOLDS THE BANKRUPTCY CODE AS CONSTITUTIONAL

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In a much-anticipated order, the Indian Supreme Court on 25 January 2019 upheld the constitutional validity of the Insolvency and Bankruptcy Code, 2016 (IBC or Code) while ruling on several key aspects of the law. These have imminent implications for both pre-IBC as well as post-IBC restructuring and debt trading transactions.

Key takeaways

- ***Financial creditors are rightfully treated differently from operational creditors under the IBC***: The Supreme Court upheld the distinction between financial creditors and operational creditors under the Code and found that operational creditors have not been treated arbitrarily under the IBC or in violation of the Constitution of India. The Court also upheld the validity of the Section 53 payment waterfall, specifically ruling that operational debts and financial debts are different and serve different purposes in an economy and legislative policy was to prefer financial debts in the Section 53 waterfall. However, the Court did note that "*NCLAT while looking into the viability and feasibility of resolution plans ..... always gone into whether operational creditors are given roughly the same treatment as financial creditors.*" Therefore, while the rights of financial creditors are safeguarded, the present uncertainty on the recovery to operational creditors under resolutions plans continues.
- ***Withdrawal from IBC upheld, but requires court to exercise discretion***: The Court upheld the constitutionality of the Section 12A withdrawal right. However, withdrawal will be permitted at the discretion of courts after taking into account the totality of circumstances. Any excessive discretion in the hands of bankruptcy courts (i.e. NCLTs) may impact pre-IBC workouts which hinge on withdrawal of insolvency petitions, at least until greater clarity emerges on how this discretion is exercised.
- ***Information Utility records are rebuttable prima facie evidence of default and no more***: Given that Information Utilities are private institutions, the Court was of the view that the records of an Information Utility were *prima facie* evidence of default by a corporate debtor which may be rebutted by it.
- ***Relief to resolution professionals as they are not quasi-judicial bodies***: The Court clarified that the resolution professional is a facilitator of the resolution process, whose administrative functions are overseen by the committee of creditors and by the NCLT, accordingly it is not a quasi-judicial body.
- ***Section 29A upheld but "relative" and "related party" narrowed***: The court upheld the constitutionality of Section 29A and re-applied its ruling in the *Arcelor Mittal case* that no resolution applicant or promoter has a vested right to bid for a

corporate debtor whether in insolvency or in liquidation. The Court also upheld the "1-year NPA disqualification ground" under Section 29A(c) citing this to be legislative policy and that one year was adequate time to cure defaults. It did, however, rule that a relative or related party to an ineligible person should not be disqualified merely because he/she/it is a relative or related party to that ineligible person. To be so disqualified the relative or related party needs to have a connection with the business activity of the ineligible person. This will help broaden the pool of eligible bidders.

- ***Order does not dismiss all tagged cases***: The Supreme Court had tagged various cases with the Swiss Ribbons petition. In many such cases stay orders had been issued pausing insolvency proceedings against corporate debtors. This order only deals with ten of these cases and that too only on the constitutional validity of the IBC. Individual cases will be dealt with on their own facts subsequently. Challenges to the RBI's 12 February Circular will be heard by the Supreme Court shortly.
- ***Order has a prominent subtext that courts should not easily intervene in economic legislations***: The Court notes that courts should not easily intervene in economic legislations and notes that the IBC has been a success. This seems to be an important subtext to the order which resonates with the BLR Committee Report that formulated the IBC.
- ***More NCLAT infrastructure ordered***: The Court recognised that access to the bankruptcy appellate tribunal (i.e. NCLAT) needs to be improved. It therefore ordered that NCLAT circuit courts be set up within the next 6 months around the country. While this can improve access and timelines, courts will need to ensure that they uphold the IBC ideal of judicial restraint and consistency of decision making.

This judgment is an important re-affirmation of the IBC and the credit change that it has begun to bring in India. While some of the present-day uncertainty over the recovery rights of operational creditors continue, on the whole, the order re-asserts the rights of financial creditors and that the IBC is a creditor-in-control model. The loosening of the 29A restriction should also assist in bringing more bidders to the table and hopefully increase recoveries.

AUTHORS: Prateek Kumar, Ashwin Bishnoi, Nikhil Narayanan

R&I India is published by the firm's Restructuring & Insolvency practice group. For further information regarding this publication please do not hesitate to contact restructuring.insolvency@khaitanco.com or any of the following partners who are members of the R&I practice group: https://www.khaitanco.com/rigroup.aspx

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Bengaluru
Simal, 2nd Floor
7/1 Ulsoor Road
Bengaluru 560 042, India

T: +91 80 4339 7000
F: +91 80 2559 7452
E: bengaluru@khaitanco.com

Kolkata
Emerald House
1B Old Post Office Street
Kolkata 700 001, India

T: +91 33 2248 7000
F: +91 33 2248 7656
E: kolkata@khaitanco.com

Mumbai
One Indiabulls Centre
13th Floor, Tower 1
841 Senapati Bapat Marg
Mumbai 400 013, India

T: +91 22 6636 5000
F: +91 22 6636 5050
E: mumbai@khaitanco.com

New Delhi
Ashoka Estate, 12th Floor
24 Barakhamba Road
New Delhi 110 001, India

T: +91 11 4151 5454
F: +91 11 4151 5318
E: delhi@khaitanco.com