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EDITORIAL

Swiss Ribbons v Union of India: The Foundation for Modern Bankruptcy Law

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Synopsis

The constitutionality of the Indian Insolvency and Bankruptcy Code, 2016 ('IBC') was recently upheld in entirety by the Hon'ble Supreme Court of India. This article considers the key conclusions of the Supreme Court's judgement and its implications for resolution of distressed companies in India.

Constitutionality of the IBC upheld

The Supreme Court's decision in *Swiss Ribbons v Union of India* upholding the constitutionality of the provisions of the Insolvency and Bankruptcy Code, 2016 ('IBC' or the 'Code') is a landmark in the development of the Code.

The IBC is a significant departure from prior insolvency regimes in India, and some of its key features are novel even by global standards. The key differentiating features of the IBC (in comparison with other developed jurisdictions) are:

1. The admission threshold is low – it is based on the factum of default without an insolvency test.
2. No class rights – the constitution of a single creditors committee comprising of only financial creditors with secured and unsecured creditors being treated equally for voting.
3. Disqualification of certain bidders from participation in the resolution process.

The Government was able to establish to the Supreme Court that these features have worked and have led to significant results in the initial years of the law. An important factor that weighed in sustaining the law was the Government's firm resolve to tackle the non-performing assets ('NPA') crisis through the enactment of the IBC, and that the Government has been alive to the problems and has amended the law to suit the needs of the situation.

The key implications of the Supreme Court judgement are as follows:

(a) The distinction between promoters/management and the corporate debtor has been judicially recognised. Displacement of the promoter or the management of a company in default can now be done relatively quickly to protect the company and its assets.

(b) The recognition that the insolvency proceedings by nature are not adversarial to the corporate debtor. The Supreme Court has concluded that the IBC is a beneficial legislation and is for the benefit of the corporate debtor and therefore the admission of a company into Corporate Insolvency Resolution Process ('CIRP') cannot be seen from the traditional lens of adversarial proceedings.

(c) The Supreme Court has imported fair and equitable treatment for operational creditors as a requirement for the approval of resolution plans. This was prompted largely by amendments to the regulations that provide that operational creditors need to be paid ahead of financial creditors (without stating the amount that needs to be paid). This also advances the law laid down by the National Company Law Appellate Tribunal ('NCLAT') in *Binani Industries* where it was held that the creditors cannot be discriminated against. Since the *Binani Industries* judgement was being (wrongly) interpreted as a requirement to treat financial and operational creditors in the same manner, the Supreme Court has provided much needed clarity on what is expected for operational creditors. Bankruptcy laws in other jurisdictions also contemplate fair and equitable treatment.

(d) In addition to the provision for withdrawal under Section 12A, withdrawal of a corporate debtor

Notes

1 The authors instructed Mr. Tushar Mehta, Solicitor General of India, on behalf of the respondent Banks and Financial Institutions in the proceeding before the Supreme Court.

from CIRP has been permitted up to the time the Committee of Creditors is constituted with the approval of the National Company Law Tribunal ('NCLT'). What is important, though, is that the Supreme Court applied Rule 11 of the NCLT Rules (which provides for inherent power) to permit the withdrawal after admission but prior to constitution of the Committee of Creditors. The recognition of the inherent powers of NCLT may introduce flexibility to the IBC process in situations that are not contemplated by the Code. Further, if the Committee of Creditors rejects a settlement proposal, it can be subjected to an appeal before the NCLT and thereafter, the NCLAT.

(e) The Supreme Court has also upheld Section 29A in its entirety whilst reading down the list of 'related parties' who have to be tested for the disqualification under Section 29A, to those who have a business connection with the Resolution Applicant. This will help in increasing the number of participants. It would also help in moderating the level of diligence required by the Resolution Applicant, the Committee of Creditors and the Resolution Professional in Section 29A compliance as regards 'connected persons', thereby reducing the cost and timelines of the CIRP process.

Conclusion

The Supreme Court judgment will have a significant impact on a number of stakeholders in insolvency resolution. It will aid in early identification and resolution given that the admission process as contemplated in Section 7 of the Code as interpreted by the Supreme Court in *Innoventive* has been validated after the constitutional test. The judgment also provides clarity on the role of Resolution Professionals and balances their roles and responsibilities and considers them as exercising administrative functions and subject to judicial supervision under Section 60(5) of the Code by the NCLT. This is an advancement of the Supreme Court's ruling that a Resolution Professional needs to place his *prima-facie* views for decision by the creditors in *ArcelorMittal*'s case.

The Supreme Court has strongly endorsed the IBC right from its inception. By upholding the constitutionality of the statute, the judgment in *Swiss Ribbons* has laid the foundation for implementation of the IBC. It brings back focus on the intent of the IBC to resolve and revive a corporate debtor and thereby significantly reinforces the efforts of the creditors and other stakeholders to achieve such end. International experts have said that it takes a couple of decades for development of case laws to guide implementation of an insolvency law. The Indian judiciary led by the Supreme Court has clearly supported a much-needed economic law, way ahead of its international peers.

The impact of the judgment will be seen and measured by the number of settlements and resolutions that will happen pre-insolvency as well as swift resolution of the corporate debtors in insolvency. This judgement will also boost the confidence of investors and bidders in acquiring assets through IBC as well as generally improve ease of doing business in India.

Way forward

The Government has constituted a Committee to look into group resolution as the next stage of evaluation of the insolvency law. The Government should also consider regulations to implement pre-packs, cross-border measures and resolution of financial service providers. This will go a long way in ensuring early identification and resolution of stressed assets.

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