Upholding validity of IBC

Why in news?

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The Supreme Court recently upheld the constitutional validity of the Insolvency and Bankruptcy Code 2016 (IBC).

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What is the significance of IBC?

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- Insolvency and bankruptcy code 2016, was introduced to resolve the bankruptcy crisis in corporate sector.
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- Under IBC, either the creditor (banks) or the loaner (defaulter) can initiate insolvency proceedings.
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- It is done by submitting a plea to the adjudicating authority, the National Companies Law Tribunal (NCLT).
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- The Insolvency and Bankruptcy Code stipulates cases should be heard within 14 days.
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- According to IBC, a financial creditor (generally banks) holds an important role in the corporate insolvency process.
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- The Committee of Creditors (CoC) includes all financial creditors of a corporate debtor.
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- The CoC will appoint and supervise the Insolvency Professional, and has the power to either approve or reject the resolution plan to revive the debtor, or can proceed to liquidate the debtor.
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- The entire process is time-bound and must be completed within a period of 180 days (a one-time extension of 90 days is possible after the completion of 180 days).
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- However, several provisions of the IBC were challenged as arbitrary and discriminatory in the Supreme court.
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What does the court say?

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- The Supreme Court upheld the IBC saying that the insolvency law was working, while it termed the recovery of bad debt marking as the end of defaulters' paradise.
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- In the working of the code, the flow of resources to the commercial sector in India has increased exponentially as a result of financial debts being repaid.
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- **On Promoters** - The SC verdict upheld **Section 29A** of the IBC.
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- The section bars promoters of bankrupt companies as well as people related to them from bidding to regain control of their assets at a discount.
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- Specifically, the section dictates that promoters of companies, which have been classified as NPAs for over a year can't participate in the resolution process of any company unless the dues are repaid.
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- However, a mere relationship with an ineligible person/promoter cannot disqualify someone from becoming a bidder for a troubled asset.
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- It has to be proved that such a person is "connected" with the business activity of the promoter.
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- **On Operational creditors**– Operational creditors are the suppliers of products and services to bankrupt companies and contractors.
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- Under Section 53 of the IBC, in the event of liquidation of the company or its sale to another entity, the dues of operational creditors rank below those of financial creditors, workmen and employees.
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- This was challenged by the operational creditors, who wanted equal treatment with financial creditors in this regard.
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- Currently, the Committee of Creditors (CoC) constituted for bankrupt firms only comprise all financial creditors, like banks.
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- And since operational creditors don't have a place in the CoC, they have no voting rights when the committee decides on what to do with an asset.
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- Thus, several operational creditors had moved the court arguing that the bankruptcy code violates Article 14.
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- But the Court justified the existing differentiation by making a salient distinction between financial debts, which are secured, and operational debts, which are unsecured.
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- Also, the original IBC contains no provision for the operational creditors to attend the Committee of Creditors of the lender banks.
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- The court noted further that there can be cases where the goods and services that are supplied by operational creditor may be substandard or they may not have been supplied at all.
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- Thus, the court rejected the plea by operational creditors' seeking parity with secured financial creditors at the time of inviting bids for the corporate resolution plan under the IBC.
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- **On Infrastructure** - The court directed the setting up of the circuit branches of the National Company Law Appellate Tribunal within a period of six months.
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- This is to ensure that people from other metropolis need not travel to Delhi for the adjudication of issues by the NCLAT.
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- **On case resolution** - Approximately 3,300 cases have been disposed of in out-of-court settlements with claims amounting to over Rs 1.20 trillion.
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- Also, the amount realised from the resolution process under the IBC was around Rs 60,000 crore, roughly 200% of the liquidation value.
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- The Court has thus provided an emphatic nod in favour of the IBC resolution process.
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What are the challenges?

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- Of about 1,500 cases admitted until December 2018, only 79 ended in an

approval of the resolution plans and liquidation in a little over 300 cases.
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- This shows that only fewer cases of corporate debtors are getting resolved.
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- Also, many cases fail to stick to the prescribed timeline of 180 to 270 days to firm up a resolution plan with elaborate hearings at NCLT benches.
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- Such delay goes against the basic premise of the law which is to ensure a swift resolution or closure.
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- However, over time, the NCLT may be better tuned to these kind of summary proceedings with capacity building and training of professionals.
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- But the challenge still lies in how quickly some of the large accounts referred to the insolvency court by the RBI, featuring huge outstanding claims, are resolved.
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What are the implications?

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- The ruling has far-reaching implications for the promoters of big defaulting companies such as Essar Steel and Bhushan Power & Steel.
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- In the case of Essar Steel, the firm's promoters, the Ruias, offered to repay around Rs 54,389 croreor 100% of the debt it owes to all the lenders and exit the insolvency process.
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- This is despite the Committee of Creditors had already voted for ArcelorMittal's Rs 42,000-crore bid for the company post its default.
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- The Ruias are depending on Section 12A of the IBC to bail them out, and so could other promoters.
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- This section allows for a withdrawal of an insolvency application before the bidding process starts if 90% of the CoC by voting share approves it.
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- Since invoking Section 12A is going to give a higher recovery for lenders in this case than the bidding amount by ArcelorMittal, the CoC could consider the offer of the firm’s promoters.
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- But the legality of this move is yet to be decided by the NCLT, and the

Supreme Court's recent ruling on the promoters could have a bearing on its judgement.
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Source: The Indian Express, Business Standard

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