

## IBC Code, 2016 Passes Constitutional Muster

**"The defaulter's paradise is lost. In its place, the economy's rightful position has been regained", WP(C)99/2018(SC)**

S.No	Description
01	<p>UOI &amp; Others <span style="float: right;">Respondents</span></p>
02	<p><b>Questions to be decided:</b></p> <ol style="list-style-type: none"> <li>1. Classification between financial and operational creditor discriminatory, arbitrary and violative of Art-14 of Col ?</li> <li>2. Sections 21 and 24 (Operational creditors have no vote in the committee of creditors) violative of Article 14?</li> <li>3. Section 12A (withdrawal of insolvency application) is violative of Article 14 ?</li> <li>4. Constitutional validity of section 29A ?</li> <li>5. Section 53 (Operational creditors ranked below all other creditors, including other unsecured creditors who happen to be financial creditors) violate Article 14 ?</li> </ol>
03	<p><b>Observation of Apex Court</b></p> <ol style="list-style-type: none"> <li>1. <b>NEITHER DISCRIMINATORY, NOR ARBITRARY, NOR VIOLATIVE OF ARTICLE 14 OF THE CONSTITUTION OF INDIA.</b>          "Since equality is only among equals, no discrimination results if the Court can be shown that there is an <b>intelligible differentia</b> which separates two kinds of creditors so long as there is some rational relation between the creditors so differentiated, with the object sought to be achieved by the Code".</li> <li>2. <b>SECTIONS 21 AND 24 NOT VIOLATIVE OF ARTICLE 14.</b>          "The financial creditors are in the business of money lending, banks and financial institutions are best equipped to assess viability and feasibility of the business of the corporate debtor. Even at the time of granting loans, these banks and financial institutions undertake a detailed market study which includes a techno-economic valuation report, evaluation of business, financial projection, etc. Since this detailed study has already been undertaken before sanctioning a loan, and since financial creditors have trained employees to assess viability and feasibility, they are in a 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 recovering amounts that are paid for such goods and services, and are typically unable to assess viability and feasibility of business. The BLRC Report makes this abundantly clear".</li> <li>3. <b>SECTION 12A IS NOT VIOLATIVE OF ARTICLE 14.</b>          "The objective of the Code as encapsulated in the <b>BLRC Report</b>, that the design of the Code is based on ensuring that —<b>all key stakeholders will participate to collectively assess viability</b>. The law must ensure that all creditors who have the capability and the willingness to restructure their liabilities must be part of the negotiation process. The liabilities of all creditors who are not part of the negotiation process must also be met in any negotiated solution. Thus, it was agreed that once the CIRP is initiated, it is no longer a proceeding only between the applicant creditor and the corporate debtor but is envisaged to be a proceeding involving all creditors of the debtor. <b>The intent of the Code is to discourage individual actions for enforcement and settlement to the exclusion of the general benefit of all creditors.</b> Also, it is clear, that under Section 60 of the Code, the committee of creditors <b>do not have the last word</b> on the subject. If the committee of creditors arbitrarily rejects a just settlement and/or withdrawal claim, the NCLT, and thereafter, the NCLAT can always set aside such decision under Section 60 of the Code".</li> </ol>

#### 4. Constitutional validity of section 29A

*“Chitra Sharma v. Union of India, Writ Petition (Civil) No. 744 of 2017, Apex observed as follows:*

Para 31..... Parliament has introduced Section 29A into the IBC with **a specific purpose**. The provisions of Section 29A are intended to ensure that among others, persons responsible for insolvency of the **corporate debtor do not participate in the resolution process.....**||

Para 32. .... The Court must bear in mind that Section 29A has been enacted in **the larger public interest** and to facilitate effective corporate governance. Parliament **rectified a loophole** in the Act which allowed a backdoor entry to erstwhile managements in the CIRP. Section 30 of the IBC, as amended, also clarifies that a resolution plan of a person who is ineligible under Section 29A will not be considered by the CoC... In the **absence** of showing that such person is **connected** with the business of the activity of the resolution applicant, such **person cannot possibly be disqualified under Section 29A(j)**”.

#### 5. SECTION 53 OF THE CODE DOES NOT VIOLATE ARTICLE 14

“It will be seen that the reason for differentiating between financial debts, which are secured, and operational debts, which are unsecured, is in the relative importance of the two types of debts when it comes to the object sought to be achieved by the Insolvency Code. We have

already seen that repayment of financial debts infuses capital into the economy inasmuch as banks and financial institutions are able, with the money that has been paid back; to further lend such money to other entrepreneurs for their businesses. **This rationale creates an intelligible differentia between financial debts and operational debts, which are unsecured, which is directly related to the object sought to be achieved by the Code.** In any case, workmen’s dues, which are also unsecured debts, have traditionally been placed above most other debts. Thus, it can be seen that 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”

**Justice-  
J. R.F. Nariman  
J.Navin Sinha**

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#### Registered office (Delhi)

4696 Brij Bhawan, 21A Ansari Road Darya Ganj,  
New Delhi-110002. INDIA

Tel : 23288101, 23265320 Fax : +91-11-23265320

E-mail : legal@inmacslaw.com, ravimdiratta@inmacslaw.com

#### Corporate office (Gurugram)

GLOBAL BUSINESS SQUARE, Building No. 32, Sector 44, Institutional Area  
Gurugram, 122002. INDIA

Tel : +91-124-4786200

E-mail : legal@inmacslaw.com, ravimdiratta@inmacslaw.com