CONSTITUTIONAL VALIDITY OF INSOLVENCY AND BANKRUPTCY CODE

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Editor's Notes: *IBC was introduced as a complete overhaul in the approach of dealing with matters of insolvency, both for incorporated entities and individuals. However, evolving from the six-decade old insolvency regime under SICA and other relevant acts was not an easy task after all. Like any new legislation of this stature was expected to face, the Code was no exception. Soon after it came into force, an application questioning the constitutional validity of the Code was preferred before the Hon'ble Madras High Court. However, the Madras High Court was pleased to uphold the constitutional validity of the Code.*

The article gives a deep insight into the said order and its implications. As we seen in the next article, the constitutional validity of IBC was upheld by the Apex Court too.

A writ petition has been filed in the Madras High Court, by Southern Polypet Private Limited, wherein the petitioner has challenged the Code as being contrary to the provisions of the Constitution of India and the Hon'ble High Court comprising Chief Justice Indira Banerjee and Justice M. Sundar has issued a notice with respect to this petition.

Southern Polypet Private Limited vs. Union of India, Madras High Court:
Major grounds of challenge:

- **No right to be heard**
- **Restriction on nature of repayment**
- **Discrimination b/w OC and FC**
- **Violation of Right to Freedom**

Major grounds:

- Sections 7, 8, 9, 14 and 31 of the Code deprives the basic right of the petitioner to present its case before being subjected to the National Company Law Tribunal (NCLT) and is contrary to principles of natural justice *e. right to be heard* (*audi alteram partem)*, principle of legitimate expectation and doctrine of fairness. Also, the act of the NCLT of not serving a prior notice on the petitioner before admitting the application is in violation of Sections 420 and 424 of the Companies Act, 2013 read with Rule 37 of the National Company Law Tribunal Rules, 2016.

- Section 8(2) of the Code imposes restriction in the nature of repayment of debt. For instance, it does not recognise a settlement by transfer of property to be a valid repayment of unpaid operational debt and requires that attested copy of record of electronic transfer from bank account of corporate debtor or attested copy of record that operational creditor has encashed a cheque issued by corporate debtor. Further, there exists no intelligible differentia while discriminating between operational and financial creditors as, under Section 8(2), only an operational creditor is required to send a notice to corporate debtor whereas a financial creditor is not required to do so. Again, the same is in contravention of Article 14 of the Constitution.

Constitutional Validity of Insolvency & Bankruptcy Code

- Sections 17 and 20 of the Code vests the management of affairs of the corporate debtor in the interim resolution professional and suspends the powers of the board of directors or the partners of the corporate debtor, as the case may be. Here, the principle contention of the petitioner is that eviction of the existing management is wholly arbitrary and based on irrational criteria, namely, existence of a suit or arbitration proceeding on the date of receipt of the notice of insolvency under Section 8(1). This is in violation of Article 19(1)(g) of the Constitution, which provides for the freedom of occupation, trade or business upon the citizens of India.

Comments:

In the case of *Sree Metaliks Limited v. Union of India*[72], the Calcutta High Court has already ruled that the AA has to adhere to the principle of natural justice while deciding application under section 7. The relevant extract of the judgment is hereunder-

Sree Metaliks Limited v. Union of India:

And

ICICI Bank v. Innoventive Industries Ltd

"Where a statute is silent on the right of hearing and it does not in express terms, oust the principles of natural justice, the same can and should be read into in."

"In an application under Section 7 of the Code of 2016, the financial creditor is the applicant while the corporate debtor is the respondent. A proceeding for declaration of insolvency of a company has drastic consequences for a company. Such proceeding may end up in its liquidation. A person cannot be condemned unheard. Where a statute is silent on the right of hearing and it does not in express terms, oust the principles of natural justice, the same can and should be read into in. When the NCLT receives an application under Section 7 of the Code of 2016, therefore, it must afford a reasonable opportunity of hearing to the corporate debtor as Section 424 of the Companies Act, 2013 mandates it to ascertain the existence of default as claimed by the financial creditor in the application"

The abovementioned rationale was reiterated by NCLAT in the case of *ICICI Bank v. Innoventive Industries Ltd*.[73]

However, one important point for consideration could be that, under the provisions of the Code, the revival plan of the corporate debtor is prepared by the committee of financial creditors, further they have the voting power and will be the decision making authority to approve the resolution plan before presenting the same to NCLT. The operational creditors are not prohibited from attending the meeting of committee of creditors and can have their say in the proceedings but they cannot be a party to the decision making. This may evoke a question on equal treatment as the financial creditors have a greater say in the making and implementation of the plan. There

Update

Subsequently, in the matter of "***Swiss Ribbons vs. Union of India***", the Hon'ble Supreme Court has upheld the constitutional validity of the Code.

Various grounds of challenge were put by the bunch of appeals, and all were serially discussed and settled by the Apex court

[72] WP 7144(W) of 2017, CalHC
[73] Company Appeal (AT) (Insolvency) No. 1 & 2 of 2017, decided on 15.05.2017.

may be certain other flaws in the Code, which the government may rapidly solve by way of an Amendment Act and a ruling of the Apex Court on the issues may also address the problems and close the doors for any fresh writ petitions challenging the constitutionality of the Code.
