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# The Constitutional Challenges and Implications of the Insolvency and Bankruptcy Code 2016 for Corporate Debtors and Creditors in India

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AYUSH BHARDWAJ<sup>1</sup> AND AMITA PAWAR<sup>2</sup>

## ABSTRACT

*The Insolvency and Bankruptcy Code 2016 (IBC), a landmark piece of legislation, aims to provide an all-inclusive and persuasive framework for bankruptcy settlement in India. However, there have been a few constitutional issues with the IBC's application and interpretation. These challenges have an impact on the rights and interests of corporate debtors and creditors, as well as the general effectiveness and efficiency of the bankruptcy process. The most important constitutional concerns and IBC implications for Indian corporate debtors and creditors are examined in this article. The three IBC components that are discussed in this article are the categorization of creditors, the function and regulation of resolution professionals, and the length and extension of the corporate insolvency resolution process (CIRP). The legal argument raised against these components before the Supreme Court and the High Courts is examined in the article, along with the decisions reached by these courts. The article also discusses the objectives and outcomes of the IBC, as well as how these decisions may affect corporate debtors' and creditors' rights and interests. The author concludes that the Supreme Court played a significant role in dealing with these concerns and upholding the validity of the IBC and its provisions. The Supreme Court has also provided guidance and clarity on a variety of issues relating to the IBC and its provisions. The Supreme Court has balanced the interests of all parties involved and made sure that the IBC reaches its goals of maximizing asset value, encouraging entrepreneurship, increasing credit availability, and balancing the interests of all parties involved.*

**Keywords:** *Insolvency and Bankruptcy Code 2016, Corporate debtors rights, Creditor classification IBC, IBC implications for creditors, Corporate Insolvency and Resolution Process.*

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## **I. INTRODUCTION**

India's insolvency and reorganisation laws are intended to be consolidated and amended by the Insolvency and Bankruptcy Code 2016 (IBC), which is a significant legal framework. It includes corporate entities, partnership firms, and private people, all of whom are subject to a time-limited procedure designed to maximise asset value, promote entrepreneurship, expand credit availability, and safeguard stakeholders' rights. The prior, disjointed, and ineffective insolvency system, which was unfriendly to creditors and prone to delays and abuse, was addressed by the establishment of the IBC<sup>3</sup>. Various parties, including financial and operational creditors, resolution experts, adjudicating authorities, the insolvency and bankruptcy board, and information utilities, are involved in the introduction of a single method for insolvency resolution, liquidation, or bankruptcy. The IBC also contains ground-breaking elements like moratorium, insolvency resolution procedures, creditor committees, resolution plans, fast-track proceedings, fresh start procedures, and cross-border insolvency laws<sup>4</sup>.

The IBC has faced difficulties during its interpretation and implementation, notably with regard to its constitutional validity, like any recently issued law<sup>5</sup>. The Supreme Court and High Courts have heard objections from a number of parties on a number of different grounds, and these challenges have broad repercussions for the rights and interests of corporate debtors and creditors as well as the effectiveness of the insolvency process. This article seeks to examine some key constitutional challenges and their implications for corporate debtors and creditors in India.<sup>6</sup>

## **II. CLASSIFICATION OF CREDITORS**

The initial challenge concerns the IBC's classification of creditors. It distinguishes between financial creditors and operational creditors, each with distinct rights and roles in the insolvency resolution process. Financial creditors, such as banks, financial institutions, and debenture holders, are entities that have lent money to the corporate debtor for a time-based consideration. In contrast, operational creditors include those who have provided goods or services to the corporate debtor or have pending dues under employment laws, like suppliers, vendors, and

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<sup>3</sup> Renuka Sane & Susan Thomas, *The Real Causes of the Insolvency and Bankruptcy Code, 2016*, 52 *ECON. & POL. WKLY.* 40, 41-43 (2017)

<sup>4</sup> Shreya Bose, *The Insolvency and Bankruptcy Code: A Critical Analysis of its Constitutional Validity*, 9 *NUJS L. REV.* 1, 5-10 (2016)

<sup>5</sup> Aparna Ravi, *The Evolution of India's Bankruptcy Framework*, in *RESOLVING INSOLVENCY: PERSPECTIVES FROM SOUTH ASIA* 13, 15-18 (Simeon Djankov & Jan Svejnar eds., 2020).

<sup>6</sup> Raghuram G. Rajan & Luigi Zingales, *The Great Reversals: The Politics of Financial Development in the Twentieth Century*, 69 *J. FIN. ECON.* 5, 8-12 (2003).

employees. The IBC confers more authority and priority upon financial creditors in several aspects:

- Only financial creditors can initiate the corporate insolvency resolution process (CIRP) against a corporate debtor when there's a default of a minimum amount, currently set at Rs. 1 crore (reduced from Rs. 1 lakh due to the COVID-19 pandemic).<sup>7</sup> Operational creditors can commence CIRP only after sending a demand notice and receiving no response or notice of dispute from the corporate debtor within 10 days.
- Only financial creditors hold seats on the committee of creditors (CoC), which holds the ultimate authority to decide on the resolution plan or liquidation of the corporate debtor.<sup>8</sup> Operational creditors lack voting rights within the CoC, except when they hold at least 10% of the total debt.
- The resolution plan submitted by a resolution applicant must prioritise payment of debts owed to operational creditors over financial creditors only if the corporate debtor undergoes liquidation. In other scenarios, the resolution plan must specify the payment of operational creditors' debts as directed by the Insolvency and Bankruptcy Board of India (IBBI), ensuring it does not fall below the amount they would receive in liquidation.

These distinctions have faced legal challenges from several operational creditors, who argue that they violate Article 14 of the Constitution. Article 14 guarantees equality before the law and equal protection of the laws<sup>9</sup>, and they contend that there's no justifiable basis for distinguishing between financial and operational creditors. Both play critical roles in the survival and revival of a corporate debtor, and the IBC's exclusion of operational creditors from the CoC and the provision of lower payment priority are seen as encroachments on their property rights under Article 300A of the Constitution.<sup>10</sup>

*Swiss Ribbons Pvt. Ltd. v. Union of India*<sup>11</sup> and *Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta*<sup>12</sup> are two major decisions in which the Supreme Court responded to these objections by upholding the legality of these distinctions. According to the

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<sup>7</sup> Arjun Gupta & Shreya Prakash, *The Insolvency and Bankruptcy Code as a Tool for Takeovers: An Analysis of Recent Trends*, 11 NUJS L. REV. 1, 3-7 (2018).

<sup>8</sup> Umakanth Varottil, *The Evolution and Effectiveness of Independent Directors in Indian Corporate Governance*, HASTINGS BUS. L.J., Spring 2010, at 137, 140-45.

<sup>9</sup> Afra Afsharipour & Shruti Rana, *The Emergence of New Corporate Social Responsibility Regimes in China and India*, U.C.DAVIS BUS.L.J., Fall/Winter 2009-10, at 175, 178-82.

<sup>10</sup> Vikramaditya S. Khanna, *Corporate Crime Legislation: A Political Economy Analysis*, 82 WASH. U.L.Q. 95, 97-101 (2004).

<sup>11</sup> *Swiss Ribbons Pvt. Ltd. v. Union of India*, (2019) 4 SCC 17.

<sup>12</sup> *Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta*, (2020) 8 SCC 531.

Supreme Court, these distinctions are supported by comprehensible differences that take into account the nature, source, duration, and magnitude of the debt as well as the role played by these creditors in determining the viability and feasibility of a corporate debtor. Additionally, the Supreme Court found that these disparities support the goals of the IBC, including asset maximisation, entrepreneurship encouragement, credit availability, and balancing stakeholder interests. According to the Supreme Court, these distinctions do not violate Article 14 or Article 300A's prohibitions against arbitrary or unjustifiable discrimination or the denial of property rights.

These rulings have the effect of increasing the power that financial creditors have over the CIRP. However, under the IBC, operational creditors are not without remedy or protection. The Supreme Court has outlined the following safeguards and benefits for operational creditors:

- Operational creditors can initiate CIRP against a corporate debtor without the need to establish the existence of a dispute, as long as they do not receive a response or dispute notice within 10 days of sending their demand notice. This threshold is less stringent than that for financial creditors.
- Operational creditors have the right to receive notifications and attend CoC meetings, along with the opportunity to provide input on the resolution plan or liquidation. They also have the right to challenge CoC decisions or the actions of the resolution professional before the adjudicating authority and the appellate authority on various grounds, including IBC violations, fraud, collusion, discrimination, etc.
- Operational creditors hold the right to receive payment for their debts with priority over financial creditors in the case of liquidation. In the case of resolution, they are entitled to receive payment in the manner specified by the IBBI, ensuring it is no less than the amount they would receive in liquidation. The IBBI has issued regulations mandating that the resolution plan provides for the payment of operational creditors based on their debt amount or at least 330 days' worth of debt, whichever is greater.
- Operational creditors enjoy the benefits of a moratorium on legal actions or recovery proceedings initiated by the corporate debtor or any third party during the CIRP. They also gain exemption from liability regarding their debt once the resolution plan is approved and executed.

### III. ROLE AND REGULATION OF RESOLUTION PROFESSIONALS

The second challenge centres on the role and regulation of resolution professionals under the IBC. Resolution professionals are insolvency experts appointed by the adjudicating authority to oversee and manage the CIRP.<sup>13</sup> They wield various powers and responsibilities under the IBC, including taking charge of the corporate debtor's management and assets, validating and consolidating creditor claims, organising and convening CoC meetings, assessing resolution plans, and submitting these plans for approval.<sup>14</sup> The IBBI regulates the conduct and performance of resolution professionals through regulations, guidelines, and directives. Resolution professionals are also subject to disciplinary actions by the IBBI or insolvency professional organisations in cases of misconduct or violations of the IBC or related regulations. The role and regulation of resolution professionals have faced challenges from multiple parties on different grounds, including:

- The appointment of resolution professionals by the adjudicating authority is seen as a violation of Article 14 and Article 19(1)(g) of the Constitution because it lacks transparent or objective criteria and infringes upon insolvency professionals' right to practice their profession.
- The powers and responsibilities of resolution professionals under the IBC are criticised for being excessive, vague, arbitrary, and unreasonable, as they interfere with the rights and interests of corporate debtors, creditors, and other stakeholders, thereby violating Article 14 and Article 19(1)(g) of the Constitution.
- The regulation and discipline of resolution professionals by the IBBI or insolvency professional organisations are criticised for disregarding fair or due process, depriving resolution professionals of their right to reputation and livelihood, and thus violating Article 14 and Article 21 of the Constitution.

The Supreme Court has dismissed these challenges in various cases, including *ArcelorMittal India Private Limited v. Satish Kumar Gupta*<sup>15</sup>, *Pioneer Urban Land & Infrastructure Ltd. v. Union of India*<sup>16</sup>, and *Manish Kumar v. Union of India*<sup>17</sup>. As stated by the Supreme Court

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<sup>13</sup> Shreya Bose & Rishabh Raheja, The Insolvency and Bankruptcy Code: A Comparative Analysis of the Resolution Process for Corporate Persons and Individuals, 4 JINDAL GLOBAL L.REV. 1, 3-7 (2017).

<sup>14</sup> Rajdeep Banerjee & Nitu Poddar, The Insolvency and Bankruptcy Code: A Critical Analysis of the Role and Regulation of Resolution Professionals, 5 J.CORP.L.STUD. 1, 4-8 (2018).

<sup>15</sup> *ArcelorMittal India Private Limited v. Satish Kumar Gupta*, (2019) 2 SCC 1.

<sup>16</sup> *Pioneer Urban Land & Infrastructure Ltd. v. Union of India*, (2019) 8 SCC 416.

<sup>17</sup> *Manish Kumar v. Union of India*, (2021) SCC Online SC 315.

- The adjudicating body appoints resolution professionals based on impartial standards specified by IBBI regulations. These requirements take experience, knowledge, accessibility, and eligibility into consideration. Furthermore, the appointment is contingent on the CoC's approval within 30 days. The public interest of ensuring an impartial and independent CIRP is served by this selection process, which does not contravene Article 14 or Article 19(1)(g).
- For the successful and efficient execution of CIRP, the powers and obligations given to resolution experts by the IBC are deemed necessary and appropriate. Various authorities, such as the adjudicating authority, appellate authority, CoC, IBBI, etc., are also in charge of monitoring them. Because they are used legally and in line with a valid objective, these powers and duties do not contravene Article 14 or Article 19(1)(g).
- The IBBI or insolvency professional organisations regulate and discipline resolution specialists in accordance with due process and in accordance with established legal procedures. The adjudicating authority and the appellate authority, among other authorities, have the power to judicially review these rules and disciplinary proceedings. Since they support the goal of sustaining high standards of expertise and integrity among resolution professionals, they do not infringe Article 14 or Article 21.

As a result of these rulings, resolution specialists will still be essential to monitoring and controlling CIRP under the IBC. The IBC still holds resolution specialists accountable, responsible, and subject to inspection notwithstanding this. They must carry out their responsibilities with the utmost seriousness, honesty, and professionalism. They must follow the rules and guidelines established by the IBBI or other insolvency professional groups. In addition, they risk discipline or punishment for any misbehaviour or contravention of the IBC or associated laws.

#### **IV. TIME LIMIT AND EXTENSION OF CIRP**

The third difficulty relates to the CIRP time restrictions and extensions under the IBC. According to the IBC, the CIRP must be finished 180 days after the adjudicating body accepts the application. If the adjudicating authority determines that an extension is necessary owing to exceptional circumstances and the CoC approves it by a vote of 66% of the voting share, the adjudicating authority may extend this time by an additional 90 days. All extensions combined

with the initial CIRP period cannot last longer than 330 days. The corporate debtor must go through liquidation if CIRP can't be finished by then.<sup>18</sup>

Several parties have filed lawsuits challenging these deadlines and extensions on various grounds, including:

- Because the 180-day or 330-day time limits are viewed as arbitrary, irrational, and impractical, they are believed to violate Article 14 and Article 19(1)(g) of the Constitution. Critics claim that these restrictions ignore the complexity and variety of situations.
- Because it depends on the subjective consent of the adjudicating authority and the CoC, which may be affected by outside considerations or nefarious purposes, the 90-day extension of CIRP is condemned for breaking Article 14 and Article 19(1)(g).
- Because it is disproportionate, severe, and unjust, and because it deprives corporate debtors and creditors of their right to property and their opportunity to revive or restructure, the mandatory liquidation of a corporate debtor after 330 days is seen as violating Article 14 and Article 300A of the Constitution.

The Supreme Court has upheld the validity of these provisions in various cases, such as *ArcelorMittal India Private Limited v. Satish Kumar Gupta*, *Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta*, and *Jaypee Kensington Boulevard Apartments Welfare Association v. NBCC (India) Ltd.*<sup>19</sup> The Supreme Court has argued that:

- The 180-day or 330-day time limits are based on rational and objective criteria designed to ensure a swift and efficient resolution of insolvency, which is in the public interest and serves a legitimate purpose. These time limits are also flexible and adaptable, as they can be extended by 90 days in exceptional circumstances with the CoC's approval.
- The 90-day extension of CIRP is governed by a reasonable and fair procedure that requires both the adjudicating authority's satisfaction and the CoC's approval, both of which are independent and impartial entities. The extension is also subject to judicial review by various authorities, such as the appellate authority.
- The mandatory liquidation of a corporate debtor after 330 days is grounded in a proportionate and just principle aimed at ensuring finality and certainty in the insolvency framework, which

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<sup>18</sup> Rajdeep Banerjee & Nitu Poddar, *The Insolvency and Bankruptcy Code: A Critical Analysis of the Role and Regulation of Resolution Professionals*, 5 *J.CORP.L.STUD.* 1, 4-8 (2018).

<sup>19</sup> *Jaypee Kensington Boulevard Apartments Welfare Association v. NBCC (India) Ltd.*, (2021) SCC Online SC 34.



is in the public interest and serves a legitimate purpose. Liquidation is also accompanied by safeguards and benefits under the IBC, including priority payment for operational creditors and a moratorium on legal actions.

These decisions effectively maintain CIRP's subject status to the IBC's stringent time constraints and future extensions. This does not imply, however, that the IBC will implement CIRP in a strict or mechanical manner. Clarification provided by the Supreme Court

- The 180-day or 330-day time limits do not apply to the time when CIRP is interrupted by a court order or while CIRP-related judicial processes are ongoing. This implies that any delays brought on by legal action or judicial interventions won't affect the deadline for finishing CIRP.
- If there are extraordinary circumstances and the CoC's consent, the adjudicating body may grant the 90-day extension of CIRP at any time before the 180-day or 330-day maximum expires. This indicates that there are no limitations on when or how frequently a CIRP extension may be requested or accepted.<sup>20</sup> If a resolution plan is accepted by the CoC prior to the 330-day deadline and presented to the adjudicating body before a liquidation order is issued, the mandatory liquidation of a corporate debtor can be avoided. This indicates that even after the CIRP time limit has passed, a settlement is still possible.

## **V. CONCLUSION**

The IBC is a ground-breaking piece of law designed to give India a thorough and cogent framework for insolvency resolution. The IBC has, however, run into a number of constitutional issues during its implementation and interpretation, just like any new law. The rights and interests of corporate debtors and creditors, as well as the general effectiveness and efficiency of the insolvency system, are significantly impacted by these difficulties. In resolving these issues and reiterating the legality of the IBC and its provisions, the Supreme Court was crucial. Additionally, in order to strike a balance between the interests of all stakeholders and ensure that the IBC achieves its goals of maximising asset value, encouraging entrepreneurship, improving credit availability, and maintaining a balance among all stakeholders, the Supreme Court has provided guidance and clarity on various aspects of the IBC and its provisions.

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<sup>20</sup> Rajdeep Banerjee & Nitu Poddar, *The Insolvency and Bankruptcy Code: A Critical Analysis of the Role and Regulation of Resolution Professionals*, 5 *J.CORP.L.STUD.* 1, 4-8 (2018).