

# Dispute Resolution Hotline

May 20, 2010

## SUPREME COURT UPHOLDS THE CONSTITUTIONALITY OF NATIONAL COMPANY LAW TRIBUNAL

The Constitutional Bench of the Hon'ble Supreme Court of India (the "**Court**") has by its order<sup>1</sup> dated May 11, 2010 upheld the constitutional validity of National Company Law Tribunal ("**NCLT**") and National Company Law Appellate Tribunal ("**NCLAT**"). However, the Court categorically ruled that Parts 1B<sup>2</sup> and 1C<sup>3</sup> of the Companies Act, 1956 (the "**Companies Act**"), that provide for the constitution and operation of NCLT and NCLAT are *ultra vires* the Constitution of India (the "**Constitution**") as presently structured. The Court has identified constitutional defects in Parts 1B and 1C which need to be suitably amended to make the provisions operational and thereby constitute NCLT and NCLAT.

## RATIONALE FOR THE CONSTITUTION OF NCLT AND NCLAT

The Government of India constituted a High Level Committee in 1999 under the Chairmanship of Justice V. Balakrishna Eradi to examine the existing laws on insolvency of companies and winding-up proceedings and suggest reforms to avoid delay involved. The Committee *inter alia* identified multiplicity of court proceedings as the most significant reason for the critical delay in dissolution of companies. In line with the laws on corporate insolvency prevailing in industrially advanced countries, the Committee recommended the constitution of NCLT and NCLAT combining the powers of the Company Law Board ("**CLB**") under the Companies Act, Board for Industrial & Financial Reconstruction ("**BIFR**") and Appellate Authority for Industrial & Financial Reconstruction ("**AAIFR**") under the Sick Industrial Companies (Special Provisions) Act, 1985 and the jurisdiction and powers relating to winding-up presently vested in the High Courts. Pursuant to the recommendations of the Committee, the Company (Second Amendment) Act, 2002 was enacted to introduce parts 1B and 1C in the Companies Act, providing for the establishment of NCLT and NCLAT.

## CHALLENGE IN THE MADRAS HIGH COURT

The constitutionality of the Company (Second Amendment) Act, 2002 was challenged in the Madras High Court on various grounds. The Madras High Court by its order dated March 30, 2004 held that establishment of NCLT and NCLAT and vesting in them the powers hitherto exercised by the High Courts and CLB was not unconstitutional. Nevertheless, the Madras High Court concluded that various provisions of Parts 1B and 1C suffered from constitutional infirmities which had to be sufficiently amended to establish NCLT and NCLAT.

## APPEAL TO THE COURT

The order of the Madras High Court was challenged in the Court on the following grounds:

- (i) Parliament does not have the legislative competence to vest intrinsic judicial functions that have been traditionally performed by the High Courts for nearly a century in any tribunal outside the Judiciary;
- (ii) The constitution of NCLT and transferring the entire company jurisdiction of the High Court to the tribunal are violative of the doctrine of Rule of Law, Separation of Powers and Independence of the Judiciary.
- (iii) The various provisions of Parts 1B and 1C of the Companies Act are defective and unconstitutional, being in breach of constitutional principles of Rule of Law, Separation of Powers and Independence of Judiciary.

## FINDINGS OF THE COURT

(i) *Parliament has the legislative competence to constitute NCLT and NCLAT*

The Court acknowledged and upheld the constitutional power of the Parliament to constitute tribunals for adjudication of disputes. The legislative competence of the Parliament to provide for creation of courts and tribunals can be traced to Articles 245, 246 and 247 of the Constitution read with various entries in the Union List (List I of Seventh Schedule) and the Concurrent List (List III of Seventh Schedule) which is in no way affected or controlled by Articles 323A or 323B of the Constitution.

Articles 323A and 323B are enabling provisions which permit the Parliament to provide for adjudication or trial by tribunals of the matters specified therein. However, the Articles cannot be interpreted to mean that the Parliament is prohibited from establishing tribunals not provided specifically under those Articles, as long as there is legislative competence under the appropriate entry in the Union List or the Concurrent List.

Therefore, even though revival/rehabilitation/regulation/winding up of companies are not matters which are mentioned in Articles 323A and 323B, the Parliament has the legislative competence to constitute NCLT and NCLAT to deal with matters arising out of the Companies Act.

(ii) *NCLT and NCLAT do not contravene the Rule of Law, Separation of Powers and Independence of Judiciary*

It cannot be assumed that constitution of tribunals and transferring judicial functions *per se* breach Rule of Law,

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Independence of Judiciary and Separation of Powers as the Constitution contemplates judicial power being exercised by both courts and tribunals. What is crucial is to ascertain whether the constituted tribunals respect and maintain the principles of Independence and Separation of Powers. The constitution of NCLT and NCLAT and the eligibility criteria of its members shall be subject to judicial review. If the court in exercise of judicial review is of the view that the Rule of Law, Independence of Judiciary and Separation of Powers are compromised by such tribunals, the court may interfere to preserve the same. Such an exercise will be part of the checks and balances to maintain the Separation of Powers and to prevent any encroachment, by other organs of the State.

(iii) *Parts 1B and 1C of the Companies Act dealing with NCLT and NCLAT suffer from constitutional infirmities*

#### A) JUDICIAL MEMBERS

Legislature cannot transfer judicial functions to a tribunal manned by persons who are not suitable or competent to discharge such judicial powers or whose independence is suspect. When the tribunal exercises judicial functions, its members cannot be drawn from various government departments or civil services who continue to be employees of different Ministries by maintaining lien over their respective posts. In such a case, it would amount to transferring judicial functions to the Executive which would go against the doctrine of Separation of Power and Independence of Judiciary. NCLT and NCLAT are judicial tribunals that exercise the jurisdiction previously vested on the High Courts. Hence the standards and qualification of its members should necessarily confirm, as nearly as possible to the qualification of High Court Judges. A lifetime of experience in administration may make a member of the civil services a good and able administrator, but not a necessarily good, able and impartial adjudicator with a judicial temperament.

Therefore, only Judges and advocates should be considered for appointment as Judicial Members of the NCLT and NCLAT. Only the High Court Judges or Judges who have served in the rank of a District Judge for at least five years or a person who has practiced as a Lawyer for ten years can be considered for appointment as a Judicial Member.

#### B) TECHNICAL MEMBERS

NCLT and NCLAT are judicial tribunals and its members should as nearly as possible have the same position and status as High Court Judges. It is not mandatory that tribunals should always have technical members. When any jurisdiction is shifted from the courts to tribunals, on the ground of pendency and delay in courts, and the jurisdiction so transferred does not involve any technical aspects requiring the assistance of experts, the tribunals should normally have only judicial members.

The Court failed to appreciate the logic in appointing members of general civil services in NCLT and NCLAT as Technical members. The Court clarified that it is wrongly assumed that company law matters require certain specialized skills which are lacking in Judges. There is also an equally erroneous assumption that members of the civil services, (either a Group-A officer or Joint Secretary level civil servant who had never handled any company disputes) will have the judicial experience or expertise in company law to be appointed either as Judicial Member or Technical Member.

Indiscriminate appointment of technical members in all tribunals will dilute and adversely affect the independence of the Judiciary. Therefore, only officers who are holding the ranks of Secretaries or Additional Secretaries alone can be considered for appointment as Technical members of NCLT. All the other criteria prescribed for appointment of Technical members under parts 1B and 1C are invalid. Persons having ability, integrity, standing and special knowledge and professional experience of not less than fifteen years in industrial finance, industrial management, industrial reconstruction, investment and accountancy, may however be considered as persons having expertise in rehabilitation/revival of companies and therefore, eligible for being considered for appointment as Technical Members.

#### C) TENURE OF MEMBERS

The term of office of members should be increased to a term of seven or five years subject to eligibility for appointment for one more term. NCLT and NCLAT should not be virtually created as an opportunity for members of the Executive to extend their period of service by five years from 60 to 65 at a higher pay applicable to High Court Judges and should include young members.

#### CONCLUSION

The establishment and constitution of NCLT and NCLAT as exclusive tribunals for the administration of all matters arising out of the Companies Act will definitely reduce, if not negate the fatal delay involved in the company law proceedings, avoid multiplicity of litigation before various fora, streamline the process of appeal and reduce the burden on High Courts. All this will make India, a more attractive destination for investment. As the Court has rightly highlighted, NCLT and NCLAT should be judicial tribunals par excellence which is possible only if the members are adequately qualified and confirm to the prescribed standards. Parts 1B and 1C, as presently structured severely dilute the constitutional principles of Rule of Law, Separation of Powers and Independence of Judiciary. Such a structure, wherein the members of the Executive are entrusted judicial functions would result in loss of confidence in NCLT and NCLAT. Hence necessary and consequential amendments are to be made to Parts 1B and 1C of the Constitution as a prerequisite to the establishment of NCLT and NCLAT.

- **Arun Scaria, Vyapak Desai & Vivek Kathpalia**

1 Union of India v. R. Gandhi, President, Madras Bar Association and Madras Bar Association v. Union of India, available at <http://judis.nic.in/supremecourt/helddis3.aspx>

2 National Company Law Tribunal, Companies Act, 1956

3 Appellate Tribunal, Companies Act, 1956

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