

## **JSA represented a financial creditor in a significant judgment where the Supreme Court has upheld the constitutional validity of Sections 95 to 100 of the IBC (concerning insolvency resolution process of individuals/personal guarantors and partnership firms)**

In the case of *Dilip B Jiwrajka v Union of India & Ors<sup>1</sup>*, a 3 (three) judge bench of the Supreme Court of India (“**Supreme Court**”) has upheld the constitutional validity of Sections 95 to 100 of the Insolvency and Bankruptcy Code, 2016 (“**IBC**”).

### **Background**

1. Sections 95 to 100 of the IBC (Part III) provide for the insolvency resolution process in respect of individuals and partnership firms. Briefly stated, as per these provisions:
  - a) A creditor may apply to the adjudicating authority (“**Adjudicating Authority**”) for initiating the insolvency resolution process by submitting an application (Section 95).
  - b) An interim moratorium commences on the date of the application and continues till the admission of the application. During the interim moratorium (Section 96):
    1. Any legal action or proceeding pending in respect of any debt will be deemed to have been stayed; and
    2. The creditors of the debtor will not initiate any legal action or proceeding in relation to any debt.
  - c) Where the application is filed through a resolution professional (“**RP**”), the Adjudicating Authority would have to confirm the appointment of the RP and where the application is filed directly by the creditor, the Adjudicating Authority would direct the Insolvency and Bankruptcy Board of India (IBBI) to appoint a RP (Section 97).
  - d) Once appointed, within 10 (ten) days, the RP is required to examine the application and submit a report to the Adjudicating Authority recommending the approval or rejection of the application (Section 99).
  - e) For examining an application, the RP may seek such further information or explanation as may be required from the debtor, creditor or any other person who in the opinion of the RP, may provide such information (Section 99).
  - f) The Adjudicating Authority will, within 14 (fourteen) days of the RP’s report pass an order either admitting or rejecting the application (Section 100).

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<sup>1</sup> 2023 INSC 1018.

2. As opposed to the above, when an application is filed under Section 7 or 9 of the IBC (Part II) seeking initiation of the insolvency resolution process of a company/corporate debtor, the RP is appointed, and moratorium is declared only once the application is admitted by the Adjudicating Authority.
3. The above provisions of the IBC have been made effective only in the context of initiation of insolvency resolution process of persons who had issued personal guarantees for securing the debt of corporate debtors against whom corporate insolvency resolution processes are underway.
4. Various individuals/personal guarantors challenged the constitutional validity of Sections 95 to 100 of the IBC on the grounds that:
  - a) The provisions of the IBC are arbitrary and contrary to Article 14 of the Constitution of India since, unlike in the case of corporate debtors, for individuals, even without admission of the application and without any judicial intervention, interim moratorium is declared and the RP is entitled seeking information from third parties.
  - b) Before initiating proceedings for insolvency and the appointment of RP or, at the minimum, before the RP takes any action, there must be a determination by a judicial body of the existence of a debt and default;
  - c) The provisions of the IBC are against the principles of natural justice since no opportunity is provided to the individual to present its case before a judicial body prior to initiation of the insolvency process or commencement of the interim moratorium. It also violates the right to privacy since the RP is entitled to obtain information from any person.

## Findings of the Supreme Court

1. In its judgment, the Supreme Court analyzed the following issues:
  - a) Comparison between the insolvency process under Part II (for corporate debtors) and Part III (for individuals) of the IBC (in respect of the role of RP, impact of moratorium and role of the Adjudicating Authority);
  - b) Applicability of the principles of natural justice; and
  - c) Constitutional validity of the statutory provisions of Sections 95 to 100 of the IBC.
2. Upon analyzing the above issues, the Supreme Court upheld the validity of Sections 95 to 100 of the IBC and held that:
  - a) The difference in the insolvency process of corporate debtors under Part II of the IBC on one hand and of individuals/partnership firms under Part III of the IBC on the other, is based on an intelligible differentia and there is no violation of Article 14 of the Constitution.
  - b) While acting under Section 99 of the IBC (Part III), the RP does not possess an adjudicatory function. He only acts as a facilitator to collate, verify and compile the relevant materials and submit it in the form of a report to the Adjudicating Authority.
  - c) Under Part III of the IBC, the RP does not have the kind of power which its counterpart has under Part II. Particularly, under Part III, the RP cannot take over the assets or the business which is being carried on by the individual/partnership firm.
  - d) The purpose of the interim moratorium under Section 96 is protective with the object to insulate or safeguard the debtor from further legal action. The interim moratorium is intended to operate in respect of a 'debt' as opposed to a 'debtor' and it does not freeze the assets and legal rights and title of the debtor. This must be contra-distinguished from the moratorium under Section 14 (Part II) which restrains the transfer, encumbrance, alienation or disposal by the corporate debtor of any of its assets, legal right or beneficial interest in such assets.

- e) In insolvency proceedings against personal guarantors there are 2 (two) distinct moratoriums serving different purposes—(i) interim moratorium initiated under Section 96 on filing of the creditors application and (ii) the moratorium imposed under Section 101 post admission order passed by the Adjudicating Authority. While the interim moratorium shields the debtor from debt-related legal actions, moratorium under Section 101 prevents the debtor from transferring, disposing, or alienating any of their assets. Therefore, the interim moratorium that is challenged by the petitioner serves to curtail any legal actions against the debtor, offering immediate legal shelter.
- f) The proceedings before the RP are not *ex-parte* (i.e. in the absence of the debtor). The IBC (particularly Section 99) provides for an engagement of the debtor with the RP at various stages. Therefore, there is compliance with the principle of audi alterum partem and there is no violation of natural justice.
- g) There is no violation of Article 21 of the Constitution of India or the debtor's right to privacy because the RP cannot conduct a roving enquiry under Section 99 (4) of the IBC. The RP is only entitled to seek information which is strictly relevant to the examination of the application and the statute casts an obligation on the RP to ensure confidentiality of all information relating to the insolvency process. The legitimate aims of establishing a comprehensive framework for individual insolvency and aiding the Adjudicating Authority justify seeking personal financial information, balancing privacy rights with the objective.
- h) Introducing a stage of hearing by the Adjudicating Authority at the time of appointment of the RP (under Section 97) to determine existence of debt would essentially amount to rewriting the statute which is impermissible in the exercise of judicial review. It will also be contrary to the timely resolution of individual insolvency as contemplated under the IBC.
- i) The report to be submitted to the Adjudicating Authority is recommendatory in nature and cannot bind the creditor, the debtor or the Adjudicating Authority. The adjudicatory function commences only after the submission of the report by the RP, and vests solely with the Adjudicating Authority.
- j) Although Section 100 of the IBC does not explicitly mention a hearing for a debtor, the requirement of a hearing has to be read into Section 100. The process before the Adjudicating Authority must be compliant with the principles of natural justice and the Adjudicating Authority is duty bound to hear the individual debtor, consider arguments supported by material particulars etc. before it comes to the conclusion as to whether the insolvency application should be admitted or rejected.

## Conclusion

In case of a debt, the liability of a company and its personal guarantor (who is generally the promoter of the company) are co-extensive. Accordingly, in case of defaults, creditors have a legal right to demand payment of the guaranteed amounts from the personal guarantors. Upon failure to discharge such obligations, the creditors have been constrained to take steps for initiation of insolvency resolution processes against the personal guarantors – such that the assets and liabilities of the personal guarantors are systematically and equitably dealt with. . The challenge to the validity of the provisions of the IBC blocked the insolvency resolution process of the personal guarantors. With this judgment, insolvency resolution processes against personal guarantors can now progress without any legal impediments.

The judgment brings relief and re-assurance to the lenders that like the principal borrowers, IBC provides for an effective mechanism to manage insolvencies also of personal guarantors - to systematically resolve the obligations assumed by such guarantors. This is a major step in bolstering the credit ecosystem of India.

## Insolvency and Debt Restructuring Practice

JSA is recognized as one of the market leaders in India in the field of insolvency and debt restructuring. Our practice comprises legal professionals from the banking & finance, corporate and dispute resolution practices serving clients pan India on insolvency and debt restructuring assignments. We advise both lenders and borrowers in restructuring and refinancing their debt including through an out-of-court restructuring as per the guidelines issued by the Reserve Bank of India, asset reconstruction, one-time settlements as well as other modes of restructuring. We also regularly advise creditors, bidders (resolution applicants), resolution professionals as well as promoters in connection with corporate insolvencies and liquidation under the IBC. We have been involved in some of the largest insolvency and debt restructuring assignments in the country. Our scope of work includes formulating a strategy for debt restructuring, evaluating various options available to different stakeholders, preparing and reviewing restructuring agreements and resolution plans, advising on implementation of resolution plans and representing diverse stakeholders before various courts and tribunals. JSA's immense experience in capital markets & securities, M&A, projects & infrastructure and real estate law, combined with the requisite sectoral expertise, enables the firm to provide seamless service and in-depth legal advice and solutions on complex insolvency and restructuring matters.

### Before the Supreme Court, the JSA team was represented by:



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