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**Dilip B. Jiwrajka v. Union of India & Ors – the Hon’ble
Supreme Court Affirms the Constitutionality of Insolvency
Resolution Process for Individuals and Partnership Firms**

INTRODUCTION

In its recent decision in the matter of *Dilip B. Jiwrajka V. Union of India & Ors*, 2023 SCC OnLine SC 1530, a three-judge bench of the Hon'ble Supreme Court ("the Court") dismissed a batch of 384 petitions (collectively "Writ Petitions") filed under Article 32 of the Constitution of India, 1950, ("the Constitution") assailing the constitutionality of Sections 95, 96, 97, 99 and 100 (collectively "Impugned Provisions") of the Insolvency and Bankruptcy Code, 2016 ("IBC") pertaining to initiation of insolvency proceedings against individuals and partnership firms as codified in Part III of the IBC. In this Ergo, we have set out the key contentions raised before the Hon'ble Supreme Court in the Writ Petitions and the observations made by the Hon'ble Supreme Court in regard to these contentions.

A BRIEF CONSPECTUS OF THE IMPUGNED PROVISIONS

Part III of the IBC contains the legal framework for insolvency resolution/bankruptcy of individuals and partnership firms. The provisions of Part III of the IBC (except provisions pertaining to "Fresh Start Process" of certain individuals) were brought into force by the Union Government through a notification issued by the Ministry of Corporate Affairs on 15 November 2019 ("Notification") "*only in so far as they relate to personal guarantors to corporate debtors.*" The constitutionality of the Notification which enforced the provisions of Part III of the IBC only to a select category of persons, viz. personal guarantors, was upheld by the Court in *Lalit Kumar Jain v Union of India*, (2021) 9 SCC 321.

In the meanwhile, various Writ Petitions were filed before the Hon'ble Supreme Court challenging the constitutionality of the Impugned Provisions on the ground that the Impugned Provisions are in contravention of Articles 14 and 21 of the Constitution.

Before discussing the challenges raised in the Writ Petition and the observations of the Hon'ble Supreme Court in this regard, it is worthwhile to set out the contents of the Impugned Provisions:

- a) **Section 95 of IBC** – A creditor may file an application to initiate insolvency resolution process against the debtor, jointly and individually or through a resolution professional ('RP' or "resolution professional") along with necessary information/documents relating to: (a) debts owed by the debtor to the concerned creditor(s); and (b) default by the debtor to pay the debt within 14 days of the service of the notice of demand; and (c) relevant evidence of such default or non-repayment of debt.
- b) **Section 96 of IBC** – When an application is filed for initiation of insolvency resolution process (either by the creditor, under Section 95 of the IBC or by the debtor itself, under Section 94 of the IBC) ("Insolvency Application"), an interim moratorium comes into force in relation to "*all the debts of the debtor*" during which period: (a) any legal action or proceeding pending in respect of any debt shall be deemed to have been stayed; and (b) initiation of any legal action or proceeding in respect of any debt by the creditors is prohibited.
- c) **Sections 97 and 98 of IBC** – Upon filing of the Insolvency Application, the adjudicating authority shall appoint a resolution professional basis the nomination/recommendation of the Insolvency and Bankruptcy Board of India. The RP may also be replaced if requested by the creditors/debtors.
- d) **Section 99 of IBC** – The RP is required to examine the Insolvency Application filed before the adjudicating authority and make a recommendation on whether the application should be admitted by the adjudicating authority. Towards this end, the RP : (a) may require the debtor to prove repayment of debt claimed as unpaid by furnishing evidence of repayment; and (b) may seek further information or explanation in connection with the application as may be required from the debtor or the creditor or any other person who, in the opinion of the RP, may provide such information, in which case, the person from whom information or explanation is sought is

required to provide such information within 7 (seven) days of receipt of the request.

Basis the information/documents received and after examining if the Insolvency Application is complete and in accordance with the provisions of the IBC, the RP files a report before the adjudicating authority recommending the admission/rejection of the Insolvency Application ("RP Report").

- e) **Section 100 of IBC** – Within 14 (fourteen) days of the date of filing of the RP Report, the adjudicating authority is required to pass an order either admitting or rejecting the Insolvency Application. In the event the application is admitted, the individual/partnership firm in question is subjected to insolvency resolution process in terms of Part III of the IBC.

In the event the Insolvency Application is rejected by the adjudicating authority on the ground that it was made to defraud the creditors or the RP, then the creditor shall be entitled to directly file an application for the commencement of bankruptcy against the concerned debtor.

CHALLENGE TO THE CONSTITUTIONALITY OF THE IMPUGNED PROVISIONS

In the Writ Petitions, the constitutionality of the Impugned Provisions was assailed on the following grounds:

- a) The existence of a debt and default is a "judicial fact" which has to be determined by the adjudicating authority at the very threshold. Accordingly, prior to appointing a resolution professional there must be a determination by a judicial body of the existence of a debt. However, under the terms of the Impugned Provisions, several actions in relation to commencement of insolvency of the individual having far reaching and prejudicial consequences, commence even prior to any judicial determination of debt and default. For instance, upon filing the Insolvency Application, automatically, without any judicial enquiry: (a) Interim Moratorium automatically comes into force; and (b) an RP is appointed with wide powers to demand information/documents .
- b) The wide array of powers conferred on the resolution professional in terms of Sections 97 and 98 of the IBC are arbitrary and hence in contravention of Article 14 of the Constitution.
- c) The debtor is given an opportunity of being heard only at the stage when the RP Report is examined by the adjudicating authority. None of the other steps which ensue subsequent to filing an Insolvency Application, including those highlighted in paragraph (a) above, accord any opportunity of hearing to the debtor in question. This is in contravention of the principles of natural justice.
- d) Further, the consequences which ensue on the debtor subsequent to the filing of the Insolvency Application itself are severe and prejudicial and often irreversible. The appointment of a resolution professional impinges the credit worthiness of the debtor. Additionally, many lending documents trigger a default when an insolvency notice is issued as a consequence of which collateral or independent debts may become invocable by a lending agency. In view of these far reaching consequences which typically trigger a domino effect, a debtor cannot be excluded from accessing remedies of an adjudicatory nature.
- e) Similar to Section 7 or Section 9 of the IBC, where a corporate debtor is given an opportunity of being heard and object to an application filed under Section 7 or Section 9 of the IBC, even at the stage of appointment of a resolution professional, the debtor should also be given an opportunity of being heard.
- f) Without incorporating a requirement for a hearing before the adjudicating authority prior to the appointment of a resolution professional, the Impugned Provisions are arbitrary and in contravention of Article 14 of the Constitution.

OBSERVATIONS OF THE HON'BLE SUPREME COURT

The Hon'ble Supreme Court dismissed the contentions of the Petitioners and upheld the constitutionality of the Impugned Provisions on the following grounds:

A. The resolution professional only performs a "facilitative task" of collating information/documents and a full-fledged judicial examination of the existence of debt and default is not required at this stage.

- When a resolution professional is appointed in terms of Section 97 of the IBC, he is appointed with the limited purpose of collating relevant information/documents and make a "recommendation" to the adjudicating authority on whether the Insolvency Application should be admitted. The RP is not conferred with any adjudicatory function whatsoever. Further, the recommendation of the RP in the RP Report is not binding on a creditor or debtor or the adjudicating authority.
- In the context of a CIRP, a resolution professional is conferred with vital roles including but not limited to taking over the management of the affairs of a corporate debtor and taking into custody and control the assets and properties of a corporate debtor. Accordingly, judicial determination on the debt and default is envisaged under the IBC at the threshold itself, prior to the appointment of a resolution professional. However, the role of a resolution professional in a CIRP has to be contra-distinguished from the role which is ascribed to a resolution professional in the context of insolvency resolution of individuals and partnership firms. Under Part III of IBC (i.e. insolvency resolution of individuals), the resolution professional does not enjoy powers analogous to a resolution professional appointed under Part II of the IBC (insolvency resolution of corporate persons). The resolution professional under Part III is not empowered to take over the assets of the individual or a business which is being carried on by the individual or the partnership. The role of

a resolution professional under Section 99 of the IBC is merely that of a "facilitator" to collate information/documents.

- In terms of Section 78 of the IBC, the *de minimus* threshold for filing an Insolvency Application is INR 1,000 which can be increased upto INR 1,00,000. The adjudicating authority would be inundated if all amounts of alleged defaults as low as INR 1,000 were to be judicially determined. Accordingly, the legislature introduced an intermediary stage wherein a resolution professional would collate and compile the relevant information/documents and submit the same to the adjudicating authority to aid the adjudicating authority in making a judicial determination of the existence of debt and default.
- In view of the above, the power of adjudication has been conferred only on the adjudicating authority which makes a judicial determination on the merits of the Insolvency Application based on reviewing the RP Report in terms of Section 100 of the IBC. Accordingly, there cannot be any challenge to the appointment of a resolution professional at an intermediate stage to conduct a fact finding to aid the adjudicating authority in its adjudication of an Insolvency Application.

B. The Impugned Provisions do not contravene the principles of natural justice.

- The Hon'ble Supreme Court held that the principles of natural justice are required to be followed in judicial/quasi-judicial as well as in administrative actions which may have an adverse impact on the individual or entity against which action is initiated. Having said that, the nature of natural justice is liable to vary with the exigencies of the situation in question.
- In relation to the Impugned Provisions, the Hon'ble Supreme Court held that Part III of the IBC does not deem a person to be a "debtor" basis an Insolvency Application filed against him. Instead a resolution professional is appointed to review the relevant facts/information and

make a recommendation on that basis. Further, while the resolution professional has been conferred with certain powers to collate information/documents from the debtor/third parties, such information sought by the resolution professional must be relevant to the examination of the Insolvency Application in question. Additionally, during the course of such enquiry, the debtor would be furnished with a fair opportunity by the resolution professional to make his representation.

- In any event, the recommendation of the resolution professional is not binding on the adjudicating authority while adjudicating the Insolvency Application under Section 100 of the IBC.
- The power of adjudication has been conferred only on the adjudicating authority which makes a judicial determination on the merits of the Insolvency Application based on reviewing the RP Report and after providing an opportunity of hearing to the debtor in terms of Section 100 of the IBC.
- Admittedly, Section 100 of the IBC does not explicitly mention providing the debtor with an opportunity of being heard. However, the mere lack of explicit mention of a hearing in a provision does not automatically make it unconstitutional since such a requirement can be read into such provision. Even in the instant case, the requirement to provide a hearing to the debtor can be read into Section 100 of the IBC in terms of which an opportunity of being heard is required to be provided to the debtor when the adjudicating authority is making a judicial termination on whether the Insolvency Application is required to be admitted.

C. The powers conferred on the Resolution Professional in terms of the Impugned Provisions do not contravene the provisions of Articles 14 and 21 of the Constitution.

- Placing reliance on its judgment in the matter of *K.S. Puttaswamy v Union of India*, (2017) 10 SCC 1, the Hon'ble

Supreme Court reiterated the requirement to balance right to privacy with legitimate state interest. The contours of right to privacy in terms of Article 21 mandates: (a) requirement of a law being in existence; (b) the pursuit of a legitimate aim; and (c) proportionality of the legitimate aims with the object being sought to be achieved. In the context of Impugned Provisions, the legislature's legitimate aim of establishing a comprehensive framework for individual insolvency and aiding the adjudicating authority justify seeking personal financial information, balancing privacy rights with the objective.

- Further, the Supreme Court reiterated that the resolution professional is only entitled to seek information which is strictly limited for the purpose of examining the Insolvency Application. Secondly, Regulation 7(2)(h) of the Insolvency and Bankruptcy Board of India (Insolvency Professionals) Regulations, 2016 read with paragraph 21 of the First Schedule obliges the resolution professional to ensure confidentiality of all information relating to the insolvency process.
- In light of the role of the resolution professional being circumscribed by the specific objective for which information/documents can be collated, combined with a duty to keep such information confidential meets the proportionality test laid down by the Hon'ble Supreme Court for right to privacy under Article 21 of the Constitution.
- Further, the clearly delineated contours of the resolution professional's role under Part III of the IBC, the limited powers conferred on him and their nexus with the legitimate object sought to be accomplished by IBC indicates that the Impugned Provisions are compliant with Article 14 of the Constitution.

D. Interim Moratorium is protective in nature and is not prejudicial to the Debtor.

- Addressing the Petitioner's contentions that an interim moratorium should not

come into force prior to judicial determination of debt and default, the Hon'ble Supreme Court observed that unlike in Section 14 of the IBC which imposes a stay on initiation/continuation of legal proceedings "against a corporate debtor", Section 96 of the IBC stipulates that there shall be a stay on legal proceedings **"in respect of any debt"**. In other words, the scope of the interim moratorium is in respect of "debt" and not the "debtor".

- Further, while a creditor is prohibited from taking any recovery/enforcement actions against the debtor during the interim moratorium, there is no prohibition on a debtor from alienating/transferring any assets during moratorium (unlike a moratorium under Section 14(1)(b) of the IBC). Such a restriction becomes effective only in the event of a moratorium imposed under Section 101 of the IBC subsequent to the approval of the Insolvency Application under Section 100 of the IBC.
- Accordingly, the interim moratorium which comes into effect immediately upon the filing of an Insolvency Application is "protective" in nature aimed at protecting the debtor from any coercive actions of its creditors and hence cannot be considered prejudicial to the debtor in question.

In view of the above observations, the Hon'ble Supreme Court dismissed the Writ Petitions and upheld the constitutionality of the Impugned Provisions.

COMMENT

In view of the constitutionality of the Writ Petitions being challenged before the Hon'ble Supreme Court, there was uncertainty on the status of applications filed before the relevant Adjudicating Authorities by creditors for the initiation of insolvency

resolution process against personal guarantors. As per the quarterly news report published by the Insolvency and Bankruptcy Board of India for the month of September 2023, we understand that as of September 2023, around 2,289 applications are pending before the Adjudicating Authorities claiming INR 1.63 lakh crore from personal guarantors. The affirmation of the constitutional validity of the Impugned Provisions would bring certainty in relation to the enforceability of the provisions pertaining to insolvency resolution of individuals.

As mentioned above, the provisions of Part III of the IBC are currently applicable only to a personal guarantor of a Corporate Debtor. It is clear that with this judgment, any uncertainties regarding the enforceability of the provisions of Part III of the IBC are resolved prior to being made applicable to all categories of individuals and partnership firms. Further, the affirmation of the constitutionality of Part III of the IBC will no doubt encourage creditors to exercise the remedy available to them under Part III of the IBC in the event of any default committed by individuals and partnership firms.

Khaitan & Co Team - Ajay Bhargava, Vanita Bhargava, Wamika Trehan and Siddhant Kumar appeared on behalf of L&T Finance in the proceedings before the Hon'ble National Company Law Tribunal, Delhi and the Hon'ble Supreme Court of India. KCO has exercised due caution in the preparation and publication of this ERGO so as to not compromise sensitive details in the interest of confidentiality.

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