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Dilip B. Jiwrajka v. Union of India & Others: Ushering in Greater Recovery for Creditors

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I. INTRODUCTION

In a recent landmark ruling handed down on 9 November, 2023, in the case of *Dilip B. Jiwrajka v. Union of India* ("**Dilip Jiwrajka**"), the Supreme Court of India ("**SC**") clarified the extent of rights and liabilities of 'personal guarantors' ("**PGs**") to corporate debtors ("**CD**"), in relation to a corporate debtor undergoing insolvency proceedings in accordance

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with the provisions of the Insolvency and Bankruptcy Code, 2016 ("**Code**").

Under Section 5(22) of the Code, PGs are defined to mean an "*individual who is the surety in a contract of guarantee to a corporate debtor*". It is relevant to note that an insolvency resolution framework that exists for CDs was made applicable to PGs by way of Notification No. S.O. 4126 dated 15 November, 2019 ("**PG Notification**")[1] by enforcing Section 2(e) of the Code.[2] This PG Notification permitted the creditors to initiate insolvency proceedings against PGs, independent of any such proceedings initiated by the CD under the Code. Though the PG Notification was held to be legally valid in the matter of *Lalit Kumar Jain v. Union of India* ("**Lalit Kumar Jain**"),[3] some provisions of the Code it intended to operationalise – Sections 95 to 100 – remained embroiled in a legal challenge.

With this background, *Dilip Jiwrajka* can be considered a natural sequel to *Lalit Kumar Jain,* as it goes a step further and determines whether the provisions of the Code made applicable to PGs are constitutionally sound. Here, the primary issue under consideration was the constitutionality of Sections 95 to 100 of Part III of the Code ("**Impugned Provisions**"), in view of the role of the adjudicatory

[1] Ministry of Corporate Affairs, *Notification No SO 4126 dated 15 November 2019* <https://www.mca.gov.in/Ministry/pdf/Notification_18112019.pdf>
[2] *"The provisions of this Code shall apply to— (e) personal guarantors to corporate debtors…"*
[3] *Lalit Kumar Jain v Union of India* [2021] 9 SCC 321.

authority ("**AA**") and the manner of application and stage of application of principles of natural justice.

II. SUMMARY OF ARGUMENTS

The petitioners challenged the constitutionality of the above-stated provisions of the Code on various grounds, presenting threefold contentions. Principally, the petitioners' counsels stoutly argued that the existing framework, as envisaged under the Impugned Provisions, allows a resolution professional ("**RP**") to usurp the adjudicatory function of the AA. The RP is entrusted with the decision-making tasks, including examining the application,[4] demanding information in connection with the application,[5] and providing the AA with a report containing their recommendations on the acceptance or rejection of the application.[6] Ideally, it must be the duty of the AA to make a ruling on (i) whether the debt exists, and (ii) whether the debtor has paid off the debt. Thus, granting the RP such unfettered powers jeopardises the sanctity of the insolvency resolution process. In its present form, the process deprives the debtor of the right to 'access remedies of an adjudicatory nature' thereby offending the principles of natural justice.

Access to such remedies, particularly in the nature of judicial (here, quasi-judicial) intervention is recognised under precedent, particularly for applications before an AA made under Sections 7 and 9 of the Code. In the matter of ***Innoventive Industries Limited v. ICICI Bank &***

[4] Insolvency and Bankruptcy Code 2016, s 99(1).
[5] Insolvency and Bankruptcy Code 2016, s 99(4).
[6] Insolvency and Bankruptcy Code 2016, s 99(7).

Another,[7] the SC held that specifically for Section 7 applications, the application of the FC must be admitted the moment the AA is satisfied with occurrence of default. In the event that such application is incomplete, the AA must abide by principles of natural justice by giving notice to the applicant to rectify the errors within seven days of receipt of such notice. Notably, the position of the apex court has been taken earlier by tribunals at the appellate levels. The principal bench of the National Company Law Appellate Tribunal ("**NCLAT**"), in its order in ***M/s. Starlog Enterprises Limited v. ICICI Bank Limited***[8], in specific reference to Section 9 applications, also underscored the general obligation of the National Company Law Tribunals ("**NCLTs**") and appellate tribunals (NCLATs) constituted under the Companies Act, 2013 to remain guided by the principles of natural justice during the conduct of proceedings.[9]

Second, the automatic activation of some actions following the filing of an insolvency application, such as the imposition of an interim moratorium under Section 96 and the appointment of a resolution professional under Section 97, must be done away with. These actions are irreversible and thus, must be introduced only after judicial adjudication.

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7 *See paras 43 and 53, Innoventive Industries Limited v ICICI Bank & Another,* [2018] 1 SCC 407.

8 See para 6, *M/s Starlog Enterprises Limited v ICICI Bank Limited* Company Appeal (AT) (Insolvency) No 5 of 2017.

9 Companies Act 2013, s 424(1).

Third and above all, enabling the RP to determine the issues of fact and law based on the hearing before them and disregarding the AA's role in judicial determination at the beginning of the process contravenes Article 14. The delayed entry of the AA, depriving the debtor and guarantor of an 'adjudicatory hearing' in Part III, is *'unreasonably distinguished'* from the model stipulated under Sections 7 and 9, which allows for judicial intervention by an AA at the very threshold. It may be noted that the latter model entrenches the principle of natural justice through obligations on the AA to, specifically, the right to a fair hearing.

Rebutting these submissions, the respondents asserted that there is no violation of Article 14 of the Indian Constitution, 1950,[10] as the distinction between individual insolvency and corporate insolvency is founded on an '*intelligible differentia'*. Specifically, it was argued that a Section 96 moratorium is distinct from a Section 14 moratorium. While the former operates on the debtor, the latter operates on the debt and hence, does not impinge on the *'beneficial interests of the debtor'*. Counsel for the respondents also argued that the two preconditions to *'reasonable classification'* of groups under statute stand fulfilled by the Code. *First*, it was submitted that Part II and Part III of the Code, comprising provisions on moratorium and interim moratorium respectively, are distinct in their objectives while being arguably aligned

[10] Article 14 of the Indian Constitution, 1950, states as follows: *"The State shall not deny to any person equality before the law or the equal protection of the laws within the territory of India*." Specifically, '*intelligible differentia*' is one of the preconditions to '*reasonable classification'* of groups, under statute. '*Intelligible differentia*' requires that such classification be anchored in distinguishable characteristics, between such grouped persons. The other precondition is that such differentiation in group, be both rational and linkable to the overall objective of the statute.

with the overall intent of the Code. On the one hand, Part II envisages the exclusion of the existing management from the affairs of the corporate debtor and a more pervasive moratorium on assets. On the other hand, Part III contemplates, at the outset, an examination by an RP on the existence of a debt, of repayment, and the repayment plan in case of continuing defaults. Second, it was submitted that both the moratorium under Section 14 and Section 96 cater to differentiable groups, being corporate entities and individuals, respectively. Therefore, there exists a valid classification in law for the insolvency resolution process across subjects in these two distinct groups.[11]

As regards the role of the RP, they emphatically stated that the role is of a recommendatory and not a discretionary nature. Their job is limited to collating claims and submitting their recommendation to the AA regarding the application. Under no circumstances can they bind the AA with their advice. Besides, the RP, while examining the application, upholds the principles of natural justice by offering an adequate opportunity to the debtor to present their case.[12]

III. HOLDING & ANALYSIS OF THE VERDICT

A. Maintaining the Sanctity of the Principle of Natural Justice

[11] *Dilip Jiwrajka*, 32, 35.
[12] Insolvency and Bankruptcy Code 2016, s 99(2).

Though the doctrine of natural justice encompasses three legal precepts,[13] two of them were the focus of attention in the verdict – *audi alteram partem* and reasoned decisions. The 3-judge bench, in this matter, opined that Section 99(2) of the Code expressly recognises the *audi alteram partem* rule, which states that no concerned party should be condemned without first being heard. Notably, the plain interpretation of the expression *"may require the debtor to prove repayment of the debt"*[14] signifies that the debtor is granted the 'right of hearing', i.e., they are allowed to furnish an explanation regarding the repayment of the debt. Interestingly, unlike Section 99(2), Section 100 does not explicitly provide the debtor with the opportunity of a fair hearing. However, the Court read such a condition into the provision to mean that the AA arrives at a decision only after allowing the debtor to make representations and assessing all relevant evidence presented before it.[15] Equally important, the rule of reasoned order is contained in

[13] The three pillars of the principle of natural justice are *nemo judex in causa sua* (a person cannot be a judge in their own cause), *audi alteram partem,* and reasoned orders. See *The Chairman, State Bank of India and Anr v MJ James* [2021] SCC Online SC 1061.

[14] Insolvency and Bankruptcy Code 2016, s 99(2) states that: "*Where the application has been filed under section 95, the resolution professional may require the debtor to prove repayment of the debt claimed as unpaid by the creditor by furnishing - (a) evidence of electronic transfer of the unpaid amount from the bank account of the debtor; (b) evidence of encashment of a cheque issued by the debtor; or (c) a signed acknowledgment by the creditor accepting receipt of dues.*"

[15] It is hornbook law that judicial, quasi-judicial, and administrative authorities are duty-bound to construe a statute in such a manner that the affected party is afforded a hearing unless it specifically states otherwise. For instance, in *Mangilal v State of Madhya Pradesh* [2004] 2 SCC 447, the apex court held: "*Even if a statute is silent and there are no positive words in the Act or the Rules made thereunder, there could be nothing wrong in spelling out the need to hear the parties whose rights and interest are likely to be affected by the orders that may be passed, and making it a requirement to follow a fair procedure before*

Section 99(9), which postulates that the RP must submit a report with the reasons supporting either acceptance or rejection of the application. Therefore, it can be concluded that the provisions of Part III called into question in the matter safeguard the principles of natural justice by complying with the aforementioned legal requirements.

There is one more crucial aspect of the principles of natural justice that is enshrined in the Code, yet goes unaddressed in the judgement – the right to copies of documents. Section 99(10) of the Code prescribes a requirement for the RP to provide a copy of the report, containing its recommendations, to the debtor or the creditor. Interpreting this section, the Bombay High Court, in *Surendra B. Jiwrajka v. Omkara Assets Reconstruction*,[16] held that the RP abides by the principle of natural justice by supplying the debtor or the creditor with a copy of the report. That said, one may argue that a literal interpretation of sub-section (10) may imply that the RP will furnish the copy to the debtor only when the application is filed by the debtor under Section 94. To dispel confusion, the Insolvency and Bankruptcy Board of India ("**IBBI**") recently clarified that the RP must give a copy of the report to both the debtor and creditor, regardless of who files the application.[17]

taking a decision, unless the statute provides otherwise. The principles of natural justice must be read into unoccupied interstices of the statute, unless there is a clear mandate to the contrary. No form or procedure should ever be permitted to exclude the presentation of a litigant's defence or stand."

[16] *Surendra B Jiwrajka v Omkara Assets Reconstruction* Writ Petition [2021] 6 Bom CR 177.

[17] Insolvency and Bankruptcy Board of India, Circular No IBBI/II/66/2024, <https://ibbi.gov.in/uploads/legalframwork/0ed6df8b1d8f1ef6bb762a375645a02b.pdf>

B. Role of Resolution Professional

At the outset, it is important to highlight that the SC ruled that the argument that an RP nominated by the creditor is biased against the debtor, thereby compromising the fairness of the insolvency resolution process, is untenable. Notably, Section 98(1) provides that a debtor retains the right to replace the RP appointed under Section 97, enabling them to request a different RP, if necessary. This provision, thus, removes the element of bias and preserves the impartiality of the process.

On the role of the RP, the SC made it abundantly clear that the RP is vested with non-adjudicatory power and is primarily responsible for collating facts relevant to the application. They perform only a facilitative exercise that ultimately culminates in a report having only a recommendatory value and not the judicial function of ascertaining the existence of the debt. Therefore, the question of unjustness does not even arise. Alongside, the Court discarded the assertion that, for the purposes of Section 99(4), an RP is empowered to conduct a *'roving enquiry'* into the dealings and transactions of the debtor or personal guarantor without granting them a prior hearing. Specifically, the Court referenced Section 99(4), in the context of Parliament's legislative intention to limit scope, in the grant of powers to the RP. It was held that such grant of enquiry powers is limited to facilitate the RP's ultimate recommendation in the report on the nature of the insolvency application itself, and not on other ancillary matters even in cases of third-party requests. Such enquiry must be pointed and specific to the resolution application. Therefore, it is evident from the construction of the section that the RP limits the enquiry's scope to the application filed under Section 94 or 95

alone. It also expressed its disagreement with the petitioner's stand that the RP seeking information concerning the application is tantamount to an invasion of the privacy of the debtor and the personal guarantor. The SC observed that the activity of *'soliciting information pertaining to application'* falls under one of the exceptions to the right to privacy as carved out in *K.S. Puttaswamy v. Union of India*[18] – *'the pursuit of a legitimate aim'*. Here, the task of obtaining particulars is undisputedly a prerequisite for achieving the '*legitimate aim'* of smooth and successful functioning of the individual insolvency resolution process.

C. Role of Adjudicatory Authority

The SC agreed with the respondents' submission that the AA performs the *'true adjudicatory function'* under Section 100 of the Code upon receiving the report prepared by the RP as per Section 99. Under no circumstances can an RP bind the AA with their recommendation, and the AA can always exercise its discretion to admit or reject an application. The Court also noted that the provisions of Section 99 do not carry any dire civil consequences for the debtor. *In Mohinder Singh Gill v. Chief Election Commissioner*,[19] the apex court defined the phrase '*civil consequences'*. It entails *"infraction of not merely property or personal rights but of civil liberties, material deprivations, and non-pecuniary*

[18] *KS Puttaswamy v Union of India* [2017] 10 SCC 1: The Supreme Court established the three-fold requirement to strike a balance between the right to privacy and legitimate state interests: (a) legality, i.e., the requirement that the action is sanctioned by law; (b) action is necessary to accomplish a legitimate aim; and (c) proportionality, i.e., the rational nexus between the legitimate aims and the methods to achieve them.

[19] *Mohinder Singh Gill v Chief Election Commissioner* [1978] 1 SCC 405.

damages". Indubitably, none of these are a result of the actions undertaken by the RP in accordance with the provision. More importantly, a person is deemed a '*debtor*' before Section 100 only for the purposes of initiating the insolvency resolution process. Since a person is not regarded as a debtor in the real sense until the AA makes its final decision, no injury can be inflicted on the debtor at the Section 99 stage.[20]

IV. POTENTIAL IMPACT OF THE RULING

The SC, while deciding whether Sections 95 to 100 violate Articles 14 and 21 of the Constitution, rejected a batch of 384 petitions. In one of these matters, later tagged with the batch of appeal petitions,[21] the SC issued a stay order in an erstwhile ongoing insolvency proceeding against PGs. Specifically, the apex court refrained the petitioner from transferring or disposing of assets and restrained the resolution professional from taking further action. In the wake of the much-needed clarification provided by *Dilip Jiwrajka*, we may expect the resumption of proceedings against PGs in AA.

Another positive impact of the verdict is that it can result in a rise in bank realisations of corporate dues from PGs. According to the latest data

[20] The Court distinguished the instant case from *State Bank of India v Rajesh Agarwal* [2023] SCC Online SC 342. In that case, the apex court observed that the classification of the borrower's account as fraud without allowing them to be heard entailed material civil consequences for them, including blacklisting them for being 'unworthy' of credit.

[21] *Dilip Jiwrajka v Union of India* WP (C) No 307/2022.

published by IBBI,[22] till March 2024, only 383 applications were admitted out of the 2,800 applications filed. The amount of corporate debt involved in the admitted applications is approximately ₹ 4767 crores. However, the realised amount is only ₹ 102.78 crores, implying that the realisation rate is abysmally low at a mere 2.16%. With the pronouncement of the *Dilip Jiwrajka* ruling, it is reasonable to expect that the recovery rate will substantially improve as the creditors will be able to utilise the assets of PGs for the outstanding balance.

Lastly, the judgement may also serve as judicial backing for the Central Government to bring into force the provisions of the Code pertaining to other categories of individuals, including partnership firms, proprietorship firms, and other individuals. Put simply, the upholding of the constitutional validity of Sections 95 to 100 clears the path for the implementation of the insolvency regime for these entities. The debt settlement procedure prescribed under Part III will facilitate a timely and effective resolution to over-indebtedness by enabling the above-named categories to formulate a structured repayment plan. This framework will allow them to restructure their debt and ultimately achieve financial rehabilitation.

[22] Insolvency and Bankruptcy Board of India Quarterly Newsletter (January - March, 2024) Vol 30, <https://ibbi.gov.in/uploads/publication/b4ce3516920836e9ff9b1e816137bf97.pdf>