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GUARANTOR'S PARTICIPATION IN RESOLUTION
AND BANKRUPTCY OF INDIVIDUALS AND
PARTNERSHIP FIRMS UNDER IBC, 2016

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INTRODUCTION

Constitutional validity of part III (mainly section 94 to 100) of Insolvency and Bankruptcy Code, 2016 (IBC) which deals with the resolution and bankruptcy for individuals and partnership firms was challenged before the Supreme Court in the case of *Dilip B Jivrajka vs Union of India & Ors*¹. Under this Chapter III, the insolvency resolution process can be initiated by a debtor or a creditor. Section 94(1) enables a debtor who commits a default to apply, either personally or through a resolution professional, to the adjudicating authority for initiating the insolvency resolution process. Section 95(6) enables the creditor to apply for the initiation of the insolvency resolution process either by himself, or jointly with other creditors or through a resolution professional. Under sub-section (2), a creditor may apply under sub-section (1) in relation to any partnership debt owed to him for initiating a resolution process against any one or more partners of the firm, or the firm. Section 95(4) stipulates the requirements of an application made by a creditor for the initiation of the insolvency resolution process. The application is governed by the form and manner as prescribed by Rules framed by the Central Government under Section 239 of the IBC. A copy of the application has to be furnished to the debtor.

Immediately on the filing of an application under Section 94 or Section 95, an interim moratorium operates by virtue of the statutory provisions of Section 96 and ceases to have effect on the date of the admission of the application, and the adjudicating authority is required to appoint a resolution professional.

Section 97 refers the appointment of resolution professionals by the adjudicating authority and board within the given time frame.

Section 98 contains provisions for the replacement of the resolution professional. Section 99 contains provisions for the submission of a report by the resolution professional to the adjudicating authority within the 10 days.

Section 99(4) enables the resolution professional to seek further information or an explanation "in connection with the application", as may be required from the debtor or the creditor or any other person for the purposes of examining the application. The person from whom such a request is made is under an obligation to supply it within seven days. Sub-section (6) clarifies the limited ambit entrusted to the resolution professional.

ISSUE

Whether procedure for automatic imposition of interim-moratorium and the appointment of an Resolution Professional (RP), merely based on an application filed under Section 94 and Section 95 of the Code, without granting any opportunity of a personal hearing to the debtor, is violative of the principles of natural justice and manifestly arbitrary.

PETITIONER'S SUBMISSION

The procedure entailing the automatic imposition of interim moratorium and the appointment of a RP solely based on an application under Section 94 and Section 95 of the IBC, without affording the debtor an opportunity for a personal hearing, is asserted to be in violation of the principles of natural justice and deemed manifestly arbitrary. The argument posits that such actions contravene Article 14 of the

¹ Writ Petition (Civil) No 1281 of 2021.

Constitution of India, 1950. Consequently, the petitioners advocate for the inclusion of principles of natural justice at the initial stage preceding the imposition of interim moratorium and the appointment of a RP.

The petitioners additionally contend that the framework should encompass a mechanism for resolving jurisdictional questions, specifically determining the subsistence and/or payable status of the debt, prior to appointing a RP for tasks outlined in Section 99 of the IBC. To support this stance, the petitioners draw a distinction between the procedures outlined in Part III of the IBC and those in Part II (for corporate debtors), highlighting that the imposition of moratorium under Section 14 and the appointment of an interim RP occur subsequent to judicial adjudication under Section 7 or Section 9 of the IBC. This differential treatment between Part II and Part III is asserted to be manifestly arbitrary and in violation of Article 14 of the Constitution.

Furthermore, the petitioners argue that the authority granted to the RP to "seek such further information or explanation in connection with the application as may be required from the debtor or the creditor or any other person" is excessively broad and unrestrained. This power to compel information even from third parties is considered overly expansive, and the petitioners assert that it should not be bestowed upon the RP without affording debtors a prior opportunity for a personal hearing.

Moreover, the petitioners raise concerns about the practical implications of the automatic moratorium under Section 96 of the Code. They contend that such a moratorium raises apprehensions regarding the debtor's reputation and creditworthiness, imposing a stigma that adversely affects the fundamental rights of the debtor to engage in trade or business, as guaranteed under Article 19(1)(g) of the Constitution. Additionally, the petitioners highlight that numerous lending agreements may include clauses triggering defaults upon the receipt of an insolvency notice, leading to the invocability of collateral or independent debts by lending agencies. Consequently, this results in significant legal and financial repercussions for the individual.

The gist of the argument of the Petitioner are - following ought not to take place automatically after the filing of an application under Section 95 without judicial adjudication/intervention, namely:

- (a) An automatic interim moratorium;
- (b) The automatic appointment of a resolution professional subject to worthiness;
- (c) The resolution professional seeking information from the guarantor; and
- (d) The resolution professional examining the information received and submitting a report.

CONTENTION OF THE RESPONDENT

The Respondents directed their argument towards the time-sensitive resolution of insolvency, asserting it as the "**heart and soul of the IBC**". They contended that the inclusion of personal hearings at any stage preceding Section 100 of the IBC, particularly concerning decisions on jurisdictional matters, would disrupt the envisaged timelines for resolution under Chapter III of Part III of the Code.

Furthermore, the Respondents argued that the nature of the moratorium imposed under Section 96 of the IBC differs significantly from that under Section 14 or Section 101 of the IBC. To support this assertion, the Respondents highlighted various provisions of the IBC, including those related to public announcements (Section 13(2)) and the management of the affairs of the corporate debtor (Section 17). They argued that Section 96 does not entail the same implications as Section 14, and the interim moratorium under Section 96 benefits guarantors by shielding them from additional legal proceedings.

Importantly, this moratorium is only applied to the "debt" and not to the individual. Unlike Part II, where a corporate debtor is prohibited from alienating assets, no such restrictions exist at this stage, and no adverse proceedings are triggered. Additionally, the debtor is afforded the opportunity to be heard before the Adjudicating Authority (AA) under Section 101(2) of the Code during the consideration of the resolution professional's report.

Concerning the role of the RP at the interim stage, the Respondents argued that it is purely facilitative. The RP's duties involve compiling information and preparing a report with recommendations under Section 99 of the Code. The use of phrases such as 'examine,' 'ascertain,' and 'satisfies' in Section 99(6) underscores the facilitative nature of the RP's role. The Respondents clarified that the AA is not bound by the RP's recommendations, emphasizing that the RP's role is not adjudicatory in nature.

Moreover, the Respondents asserted that the RP's inquiry is constrained by the phrase "in connection with the application" under Section 99(4) of the IBC, making it non-invasive and distinct from a fishing and roving inquiry. To illustrate, they pointed out that the questions posed by the RP are guided by the Form provided under the Insolvency and Bankruptcy (Application to Adjudicating Authority for Insolvency Resolution Process for Personal Guarantors to Corporate Debtors) Rules, 2019, and are typically relevant to commercial transactions of this nature.

RATIO AND DECISION

The Hon'ble Supreme Court ultimately determined that Sections 95 to 100 of the IBC are constitutionally valid and free from arbitrariness, thereby not infringing upon Article 14 of the Constitution. The Court emphasized that, at the juncture of Section 97 of the IBC, the Adjudicating Authority's (AA) authority is confined to the appointment of the RP. The role of the RP at this stage is limited to obtaining details about the debt and compiling a report based on the gathered information as per Section 99 of the IBC. Consequently, the Court highlighted that the adjudicatory function of the AA only initiates at Section 100 of the IBC.

The Court also noted that introducing the opportunity to raise jurisdictional questions, including those related to the existence of the debt, before Section 100 would disrupt the anticipated timelines stipulated by the IBC. Additionally, the Court emphasized that incorporating a personal hearing at an earlier stage would render Sections 99 and 100 of the Code redundant.

In this context, the Court underscored the facilitative nature of the RP's role before the Section 100 stage, where the RP compiles information from the application and requests further information, if necessary. The legislative framework envisions interaction between the debtor and the RP during the preparation of the report under Section 99(2) of the IBC. Since Section 99(2) of the IBC clarifies that the process is not *ex-parte* and takes into account the debtor's explanations, the Court concluded that the right to representation is provided even at this juncture.

Furthermore, the Court highlighted that Section 99 of the IBC does not entail adverse consequences, especially when interpreted as the Court elucidates. The information sought, especially from third parties, must be related to the application under Section 94 or Section 95 of the IBC, aligning with the Parliament's intent for a focused inquiry and not a broad investigation. The Court clarified that judicial adjudication under Section 100 of the Code must adhere to the duty of providing a personal hearing and observing principles of natural justice.

Ultimately, the Court concurred with the Respondents' argument that the IBC's timelines are of paramount importance, with distinct schematic structures for corporate entities under Part II and

individuals and partnership firms under Part III of the IBC. The Court further clarified that the interim moratorium under Section 96 of the IBC applies solely to the 'debt' and is designed for the benefit of the debtor. Thus, the Court observed that the legislature meticulously calibrated the RP's role and the nature of the moratorium under Parts II and III of the IBC, considering the intelligible differentiation between corporate entities and individual guarantors.

LEXSPECTRUM'S VIEW

The Supreme Court, in addressing the constitutionality of Part III of the Insolvency and Bankruptcy Code, consistently upholds the legislative intent through a literal interpretation of the relevant IBC provision. The Court carefully maintains a balance between the interests of the debtor/guarantor and the necessity for a time-bound resolution in insolvency proceedings. Through purposeful interpretation and safeguarding privacy, the Court restricts the authority of the RP as conferred under section 99(4), specifying that the information sought must be relevant to the preparation of a report advising the acceptance or rejection of the application.

Furthermore, the Supreme Court aligns its interpretation with the legislative intent, asserting that no judicial determination occurs until the adjudicating authority renders a decision under Section 100. It is only at this stage that the adjudicating authority decides whether to accept or reject the application, as the RP's report is deemed merely recommendatory in nature.

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