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CASELINE: THE LEGAL BRIEF

SUPREME COURT HOLDS THAT INSOLVENCY PROCEEDINGS CANNOT BE USED AS A RECOVERY MECHANISM IN CONTRACTUAL DISPUTES

The Supreme Court, in a decision concerning initiation of insolvency proceedings under the Insolvency and Bankruptcy Code, 2016 **("IBC")**, has reiterated that the IBC which is framed for the purpose of insolvency of entities under financial distress, cannot be used as a money recovery mechanism in disputes which are purely contractual in nature.

In April 2011, M/s Emerald Mineral Exim Pvt. Ltd. (the "Corporate Debtor") was desirous of purchasing a commercial unit in Synthesis Business Park, Kolkata from Bengal Shrachi Housing Development Ltd. (the "Builder"). To finance the said purchase, the Corporate Debtor obtained a loan of ₹1.50 crores from Dhanlaxmi Bank Limited **("Appellant")** in June, 2011.

A facility agreement was executed between the Appellant and the Corporate Debtor on 29 June, 2011. On the same day, a quadripartite (four-party) agreement was executed among the Appellant, the Corporate Debtor, the Builder and the West Bengal Housing Infrastructure Development Corporation Limited.

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Under the said agreement the Corporate Debtor instructed the Appellant to directly disburse the loan amount to the Builder.Accordingly, ₹1.34 crores was disbursed to the Builder in September 2011. The Corporate Debtor made repayments amounting to approximately ₹54 lakhs by April 2014.

The Corporate Debtor transferred its rights in the subject property to Jupiter Pharmaceuticals Ltd. through a nomination agreement dated 31.03.2013 without clearing the loan. Subsequently, in July 2014 the Corporate Debtor's account was classified as a Non-Performing Asset. In September 2015, the Corporate Debtor proposed one time settlement of ₹74 lakhs. However, the cheques issued by the Corporate Debtor for repayment of loan were dishonoured due to insufficient funds.

Following which, in January 2016 the Appellant initiated recovery proceedings before the Debt Recovery Tribunal **("DRT")** for ₹1.80 crores along with interest at the rate of 14.25% per annum under the Recovery of Debts Due to Banks and Financial Institutions Act, 1993. The DRT by an order dated 20 September 2016 held that the Appellant's charge over the property continued to subsist irrespective of transfer of rights to a third party, and appointed a receiver to take possession of the subject property from Jupiter Pharmaceuticals Ltd. The DRT further directed the Builder to deposit a sum of ₹1.50 crores as security provided by the Builder.

Separately, the Appellant initiated winding up proceedings against the Corporate Debtor on 28 September 2016 under the winding-up provisions in the Companies Act, 1956.

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These proceedings were later transferred to the National Company Law Tribunal **("NCLT")** and the said proceeding was treated as an application under Section 7 of the IBC, which allows a financial creditor to initiate Corporate Insolvency Resolution Process **("CIRP")** upon occurrence of a financial debt and default.

The NCLT admitted the petition and initiated CIRP against the Corporate Debtor. The suspended director of the Corporate Debtor challenged the process, in an appeal before the National Company Law Appellate Tribunal **("NCLAT").** The NCLAT vide its order dated 02 February 2022, set aside the order passed by NCLT while holding that the Appellant did not directly disburse the amount to the Corporate Debtor and, therefore, the Appellant cannot be termed as "Financial Creditor". Thus, the Appellant was not entitled to invoke Section 7 of the IBC. It was further held that the Appellant had indulged in forum shopping and that the IBC could not be used as a recovery mechanism. Aggrieved thereby, the Appellant approached the Supreme Court.

I. LEGAL FRAMEWORK

The dispute involved interpretation of the following key provisions and principles governing insolvency proceedings and debt recovery mechanism:

i. Recovery of Debts Due to Banks and Financial Institutions Act, 1993 for debt recovery through DRT;

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ii. Section 7 of the IBC, which enables a financial creditor to initiate CIRP upon existence of a financial debt and default; and

iii. The settled principle under the IBC that the objective of IBC is to address financial distress and not debt recovery. Thus, insolvency proceedings cannot be invoked merely for recovery of money where the dispute is substantially contractual in nature

II. ISSUE BEFORE THE COURT

The principal issues to be adjudicated before the Supreme Court were:

- Whether the Appellant could invoke Section 7 of the IBC for initiation of insolvency proceedings, despite the underlying dispute being intertwined with contractual obligations of the Builder.
- Whether initiation of CIRP in the present case amounted to an impermissible use of insolvency proceedings under IBC as a recovery mechanism

III. JUDICIAL ANALYSIS

The Supreme Court has reiterated in this case that existence of a “financial debt” and “default” in its repayment constitutes the foundational requirements for invocation of Section 7 of the IBC.

The Supreme Court has placed reliance upon several precedents, such as *Glass Trust Company LLC v. BYJU Raveendran & Ors. (2025) and Anjani Technoplast Ltd. v. Shubh Gautam (2026),* wherein it was noted that IBC operates as a collective insolvency resolution mechanism and not as a forum for adjudication of individual contractual claims. The Supreme Court also referred to its observation in in *Pioneer Urban Land and Infrastructure Ltd. & Anr. v. Union of India (2019)* wherein it was held that where object behind the invocation of the IBC is to compel payment rather than to address genuine financial distress, such invocation would amount to an abuse of the process.

In the present case, the Apex Court noted that the Builder had contractual obligations concerning construction, delivery and transfer of the property under the quadripartite agreement. The agreement also stipulated refund obligations of the Builder in certain situations and imposed restrictions upon transfer or encumbrance of the property without consent of the Appellant. Given the circumstances, the Supreme Court observed that the loan disbursement was closely tied to the Builder's performance of its contractual obligations. Therefore, this case could not be treated as a straightforward financial debt default scenario warranting initiation of CIRP. The dispute between the parties was predominantly contractual in nature and a subject matter of DRT proceedings.

Additionally, it was noted that recovery proceedings were already pending before the DRT and that the Builder had deposited the security amount of ₹1.50 crores pursuant to directions issued by the DRT. According to the Apex Court, permitting insolvency proceedings in such circumstances would effectively convert the IBC into a recovery mechanism, which is impermissible in law.

IV. CORE LEGAL PRINCIPLES

The Supreme Court reiterated the following principles:

- Section 7 of the IBC can be invoked only where there exists a clear financial debt and default in repayment;
- The IBC is a collective insolvency resolution mechanism and not a substitute for recovery proceedings;
- The IBC must not be weaponised as a coercive debt collection mechanism;
- Where a dispute is predominantly contractual and already subject to adjudication before an appropriate forum, it does not fall within the ambit of the IBC

V. DECISION

Applying the above principles, the Supreme Court held that the present dispute did not involve a straightforward financial debt-default situation warranting initiation of CIRP under Section 7 of the IBC.

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The Court observed that the dispute was predominantly contractual in nature and was already the subject matter of proceedings before the DRT, which was the appropriate forum for adjudication of recovery claims.

Accordingly, the Supreme Court dismissed the appeal and upheld the order passed by the NCLAT setting aside initiation of CIRP against the Corporate Debtor.