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LENDERS FREE TO INVOKE PERSONAL GUARANTEES OF CORPORATE DEBTOR UNDER THE INSOLVENCY AND BANKRUPTCY CODE, 2016

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Introduction

The Supreme Court of India in the case of *Lalit Kumar Jain v. Union of India & Ors.* by its judgement dated 21 May 2021 upheld the validity of notification no. S.O. 4126 (E) dated 15 November 2019 ("**the said Notification**") issued by the Central Government, which brought into force provisions relating to personal guarantors to corporate debtors with effect from 1 December 2019. Additionally, the Apex Court held that approval of a resolution plan against a corporate debtor *ipso facto* does not absolve a personal guarantor to the corporate debtor of liabilities under the contract of guarantee as the same arises out of an independent contract.

Background of the Dispute

By the said Notification, the Central Government notified that certain provisions of the Insolvency and Bankruptcy Code, 2016 ("**Code**") specifically under Part III of the Code are applicable only to a personal guarantor to a corporate debtor and not to other individuals in exercise of the powers conferred under Section 1 (3) of the Code. The said Notification was challenged in various High Courts across the country. The Supreme Court transferred all such matters to itself to expeditiously deal with the issue at hand and to avoid any conflicting decisions.

Arguments by the Petitioners

Some of the key contentions of the petitioners were that:

- (i) The said Notification is an exercise of excessive delegation and the Central Government has no authority to impose conditions on the enforcement of the Code only with respect to certain entities. It was also contended that the power as provided to the Central Government under Section 1(3) of the Code is only for providing flexibility with respect to time i.e., different dates on which different provisions of the Code can be enforced and does not give the authority to limit the application of provisions to certain categories or class of people.
- (ii) There is no intelligible differentia on the basis of which certain provisions are applied only to personal guarantors to corporate debtors and not to other classes of debtors like individuals and partnership firms. It was also contended that several provisions falling under Part III of the Code are being applied to

personal guarantors, however, Part III does not apply to personal guarantors to a corporate debtor at all.

- (iii) The liability of guarantor is co-extensive with that of principal debtor and as and when the principal debtor is absolved of this liability, the guarantor is also exonerated.
- (iv) The said Notification has affected the ability of personal guarantors to recover the amount from corporate debtor during the insolvency process as well as after that. It was contended that Section 140 of the Indian Contract Act, 1872 gives guarantor the right to exercise any right which creditor had against the corporate debtor once the creditors claim has been settled. This right also allows the guarantor to file a resolution plan against the corporate debtor after conclusion of the creditor's resolution process. However, by virtue of Section 29A of the Code, promoters of corporate debtors, who in most cases are also the persons who provided personal guarantees, are barred from filing a resolution plan in the corporate insolvency resolution process.

Arguments by the Respondents

Some of the key contentions of the respondents were that:

- (i) Executive has the power under Section 1 (3) of the Code to bring into force a provision of the statute at different times for different purposes. It was argued that there exists an anomaly in the Code as of now, as corporate guarantor is covered under Part II of the Code and can be included in the process of insolvency, however there is no provision to cover personal guarantor, despite both the corporate and personal guarantor being in the same class.
- (ii) In 2018, through an amendment to the Code 3 (three) different classes of debtors were introduced in the Section 2(e) of the Code i.e., personal guarantor to corporate debtor (Section 2 (e)), partnership firms (Section 2 (f)), and individuals (Section 2 (g)). The intention behind such an amendment was that the Parliament wanted to deal with personal guarantor of a corporate debtor differently from partnership firms and individuals. In this regard, through an amendment to the Code in 2018, personal guarantors were also included in Section 60 (2) of the Code for the process of insolvency and bankruptcy. The intention of the legislature and the Central Government has been to unify the process of insolvency of corporate debtor and personal guarantors to corporate debtor so as to allow the adjudicating authority to have a clear view on assets, resources and liabilities of all the parties.
- (iii) Till the time debt is paid to the creditor in entirety, a guarantor is not absolved of its joint and several liability to make payment of the amounts outstanding in favor of the creditor.

Analysis and Decision of the Court

The Court held that different provisions of the Code were enforced at different times by the Central Government depending upon the objective of the Code with respect to a provision and priority assigned to it. The Apex Court also held that bringing personal guarantor under the ambit of insolvency process is in furtherance of the objective of the Code. Further, it noted that personal guarantors to a corporate debtor are a different class of individuals and this different class has necessary recognition and statutory backing in the form of 2018 amendment (in Section 2(e) and Section 60) and

not through the said Notification. Therefore, there is no delegated legislation through the notification.

The Court also held that it was always the intention of the Parliament through the 2018 amendment and the said Notification to treat a personal guarantor as a different category from other categories of individuals and therefore, certain provisions were made applicable to personal guarantors and not to other individuals. The Court also recognised the proximity of personal guarantor with corporate debtors as compared to partnership firms and individuals. It also held that unifying the process of insolvency with respect to different entities i.e., corporate debtor, personal guarantor, and corporate guarantor will allow the adjudicating authority i.e., NLCT to view the whole picture and will provide momentum to the process of insolvency. Further, it noted that sanction of a resolution plan per se does not operate as a discharge of a personal guarantor's liability.

[Comments](#)

The affirmation of the said Notification by the Apex Court will ensure that on approval of a resolution plan, the personal guarantor to a corporate debtor does not ipso facto get absolved from the liability of the residual amount remaining even after the insolvency process. Further, the judgement will strengthen and speed up the corporate insolvency resolution process as lenders will be allowed to proceed separately against personal guarantors even while proceedings against the corporate debtor are pending or concluded. It will also aid lenders to recover maximum amount of debt without allowing the promoters / personal guarantors to a corporate debtor to be absolved of personal liability, merely because the corporate debtor has gone into insolvency.

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