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Personal guarantee: A loophole finally plugged

The Insolvency and Bankruptcy Code, 2016, is still embryonic and constantly evolving. At this stage, it is of utmost importance that issues that lack absolute clarity be settled promptly to avoid any obstacles to the smooth functioning of the code.

In the absence of the requisite amendments and/or notifications, the task of resolving interpretational issues falls to the judiciary, which in the case of the code technically means the National Company Law Tribunal (NCLT) and the National Company Law Appellate Tribunal (NCLAT) as sections 63 and 231 of the code bestow exclusive jurisdiction upon the NCLT and NCLAT for all matters under the purview of the code.

While the code is categorical that no civil court except the Supreme Court may intervene in matters pertaining to the code, there appears to be a tendency towards civil court involvement. In *Sanjeev Shriya v State Bank of India & Ors*, Allahabad High Court held that a moratorium granted under section 14 of the code would extend to personal guarantors as well as the corporate debtor.

However, this view was upheld by the NCLAT in *State Bank of India v Mr V Ramakrishna & Veasons Energy Systems Private Limited*. The NCLAT's finding flows from an appeal filed by State Bank of India, in its capacity as the financial creditor, against the order of the NCLT, Chennai, restraining the bank from proceeding against the assets of Veasons Energy Systems and Ramakrishnan, the corporate debtor and the personal guarantor respectively, under the provisions of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, until the expiry of the moratorium

period. Ramakrishnan, who was also the promoter of Veasons, had mortgaged his assets and given personal guarantees in respect of facilities the bank granted to Veasons.

The NCLT's view was that if the bank succeeded in its claim against Ramakrishnan, Ramakrishnan would step metaphorically into the shoes of the bank and thus would be entitled to all the bank's rights vis-à-vis Veasons. This would automatically create a new charge over Veasons' assets, which is explicitly prohibited under section 14(1)(b) of the code. Section 14(1)(b) has its roots in section 128 of the Indian Contract Act, 1872, which provides that the liability of a guarantor exists simultaneously with that of the principal debtor and not as an alternative.

The NCLAT in its ruling observed that if the financial creditor intends to initiate proceedings against the personal guarantor, it has the option of initiating separate bankruptcy proceedings before the same adjudicating authority. This analogy can be drawn from the settled law that the liability of a principal borrower and guarantor are co-extensive under section 128 of the Indian Contract Act. Indian courts have often observed that a creditor can simultaneously proceed against the borrower and the guarantor to recover its money, the only exception being that the creditor should approach the courts with clean hands and should not be seeking to unjustly profit from doing so.

Indian courts have also held that a creditor may proceed against a guarantor without exhausting all its remedies against the borrower. The issue of simultaneous liability arose before the NCLT, Delhi, which allowed a financial creditor to become a member

of the committee of creditors of both the corporate debtor and the guarantor.

Further, relying on sections 30 and 31 of the code, the NCLAT held that in the event that the committee of creditors and subsequently the NCLT approve a resolution plan meeting the requirements of section 30(2), the plan would be binding not only on the corporate debtor but also on its employees, members, creditors, guarantors and other stakeholders including personal guarantors. This goes to say that if the resolution plan would include and be binding on the personal guarantor, the moratorium should be extended to the personal guarantors and not be restricted to the corporate debtor.

The issue of personal guarantees is one of many teething issues which require patience and efficient amendments that are focused on filling the gaps in the code. This is also necessary to ensure that the code is not abused by the unscrupulous to delay adjudication. The NCLAT's ruling brings much-awaited relief to personal guarantors and also thwarts the efforts of forum shoppers who indulge in multiple litigations and abuse the process of law. However, it is imperative that the Insolvency and Bankruptcy Board of India settle the issue of action against the personal guarantors of corporate debtors who come under the purview of moratorium.

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