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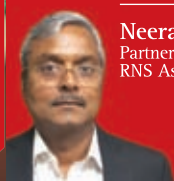
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IBC & It's Ever Evolving Conscience on Personal Guarantees

■ Sachin Gupta & Pragya Khaitan



IBC has become one of the most important legislative development that India Inc. would have witness in the current century. While on one hand the code aims to create an economy that has a clean canvas wrt its finances, on the other, there are several notes of contrary views that still need to be addressed to. The current legal scenarios are reminiscent of the clash between adjudicating authorities who have been deliberating on difference of opinions which in turn led to uncertainty and chaos that certainly needs to be addressed in a unison.

No doubt, difference of opinion is a right as well as a prerogative. However, when it comes to the opinion of courts, the same opinion become binding by virtue of being a "settled law". This raises a question, as to what the best approach is when we have differing views on the same subject matter. It is a matter that calls for extremely careful consideration and assessment of the finer points of law. Needless to say, such conundrums have been a part of various situations in the past, one of the recent ones, is the differing view taken by the Bombay High Court and the NCLAT with respect to the applicability of moratorium to personal guarantors under the Insolvency and Bankruptcy Code, 2016 (IBC).

IBC by virtue of being a new law is constantly evolving. At this stage, it is of utmost importance that issues lacking 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 under

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) sections 63 and 231 of the code bestow exclusive jurisdiction upon the NCLT and NCLAT for all matters under the purview of the code.

The code is categorical that no civil court except the Supreme Court may intervene in matters pertaining to the code. 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 debtors. While, the Bombay High Court in *Sicom Investments and Finance Limited vs. Rajesh Kumar Drolia & Ors*, held that the personal guarantors would not come under the purview of moratorium. This, in turn allowed the lenders to invoke the personal guarantees simultaneously while the borrower was undergoing insolvency.

While the High Courts had differing views on this subject matter, so did the NCLAT as may be evidenced from its decision in *Schweitzer Systemic India Private Limited vs. Phoenix ARC and Alpha & Omega Diagnostics vs. Asset Reconstruction of Company India Limited* where it was held that the moratorium provision will only affect the assets of the insolvent borrower and not the guarantors.

It is prudent to note that the said judgements are absolutely contrary to a recent decision of the NCLAT, where it held that personal guarantors are covered by moratorium in the matter of *V. Ramakrishnan and Veasons Energy*. This flowed from an appeal filed by State Bank of India, in its capacity as the financial creditor, against the



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order of the NCLT, Chennai, restraining the bank from proceeding against the assets of Veesons Energy Systems and Ramakrishnan, the corporate debtor and the personal guarantor respectively, under the provisions of the SARFAESI Act, 2002, until the expiry of the moratorium period. Ramakrishnan, who was also the promoter of Veesons, had mortgaged his assets and given personal guarantees in respect of facilities the bank granted to Veesons.

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 Veesons. This would automatically create a new charge over Veesons' 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 Hon'ble 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. The said 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, 1872. 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 rightful intent 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.

Further, relying on the 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 implies 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 only be restricted to the corporate debtor.

The issue of personal guarantees is amongst the various issues that require a patient approach and efficient amendments focused on filling the gaps

in the code. The Insolvency Law Committee in its March, 2018 report has concluded that section 14 does not intend to bar actions against assets of guarantors to the debts of the corporate debtor and recommended that an explanation to clarify this may be inserted in section 14 of the Code as the scope of the moratorium may be restricted to the assets of the corporate debtor only. Therefore, we may expect an amendment in this regard. Also, it is necessary to ensure that the code is not abused by unscrupulous players with the intent to delay adjudication. The NCLAT's ruling brings much-awaited relief to the personal guarantors and also thwarts the efforts of forum hoppers who indulge in multiple litigations and abuse the process of law. However, it is imperative that the Insolvency and Bankruptcy Board (IBBI) of India settles the issue of action against the personal guarantors of corporate debtors who come under the purview of moratorium.

The powers are required to be well defined as the High Court may exercise its constitutional jurisdiction and jurisdiction under relevant statute. The conflict between the decisions of NCLT / NCLAT and High Court will necessarily crop up, as the NCLT / NCLAT exercises jurisdiction under the Code and any appeal against such decisions of NCLAT, are to be filed before Hon'ble Supreme Court. The exclusion of jurisdiction of High Court under Code will not result in exclusion of powers of High Court under Constitution. The powers and functions of High Courts have not been described in detail in the constitution. Before the present constitution was adopted, the High Courts with well-defined powers, were functioning in different states. Thus, the framers of the constitution did not feel the need of describing in detail the jurisdiction of High Courts. On the other hand, the Supreme Court, being a new creation, required a clear definition of its powers and jurisdiction. It is not surprising that

the issue of personal guarantors, as mentioned above, was referred to the Supreme Court for resolving the same.

The SBI has sought the Supreme Court view on whether the liability of a personal guarantor of a company under insolvency resolution process can be enforced when a moratorium against the corporate debtor for recovery of dues falls under the IBC Code. The apex court will also assess whether the benefits of such moratorium would be available to such an individual/personal guarantor in case the insolvency resolution process has not been initiated and whether a secured creditor is entitled to initiate proceeding for recovery independently against the personal guarantor without initiating action against the principal borrower.

A guarantee is an accessible and opportune form of security available to the lenders. The liability of a guarantor is co-extensive with that of a borrower. It is also prudent to note that the net worth of the guarantor is crucial to the ability and credit worthiness of the borrower to adhere to the terms of the loan. The lack of clarity in IBC qua the applicability of moratorium to the personal guarantors has resulted in the onset of anxiety and apprehension amongst the lenders with respect to the guarantors. In view of the same, contradicting views on the topic by the Bombay High Court and NCLAT have only added to the existing state of confusion. There is a definite need for clarity and transparency in the matter and the same can be achieved only if the Hon'ble Supreme Court concludes the legal position.

It is very important to define the respective centers of authority and their constitutional duties when it comes to exercising the code in such practical instances. Differing opinions and views from various High Courts or the Apex Court is not only discouraging but can also create judicial activism due to lack of clarity in this regard. [w](#)



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