



*Anirudh Suresh
Principal Associate*

SUPREME COURT ON ADJUDICATING AUTHORITY FOR PERSONAL GUARANTORS

Introduction

The Central Government had notified¹ few provisions² of the Insolvency and Bankruptcy Code, 2016 (“**Code**”) as well as the rules³ relating to insolvency resolution process and bankruptcy process of personal guarantors to corporate debtors. This is to recognize personal guarantors as a separate species under the Code. However, a slew of Write Petitions⁴ were filed before various High Courts challenging the validity of the notification and interpretation of common question of law as the approval of Resolution Plan would extinguish the liability of the Personal Guarantors of the Corporate Debtor. This led to the Supreme Court (“**SC**”) to transfer⁵ all these petitions to itself at the Central Government’s request and gave its verdict.⁶

Brief Analysis of the Supreme Court Verdict

It was challenged that the notification was selectively applicable only insofar as they relate to personal guarantors of corporate debtors. Justice Ravindra Bhat upheld the notification stating that it is not an instance of legislative exercise or amounting to impermissible and selective application of provisions of the Code as the Central Government has always followed a stage-by-stage process of bringing into force the provisions of the Code since its inception in 2016.

The essence or importance of this verdict, however, lies with regard to the position of the National Company Law Tribunal (“**NCLT**”) which will be the adjudicating authority for Personal Guarantor if a parallel Corporate Insolvency Resolution Process (“**CIRP**”) is pending in respect of the Corporate Debtor for whom the guarantee is given. The rationale of the SC for confirming NCLT as the appropriate adjudicating authority for any action against personal guarantors of Corporate Creditor is:

¹ S.O. 4126 (E) issued by the Ministry of Corporation Affairs, Central Government dated 15.11.2019

² https://www.mca.gov.in/Ministry/pdf/Notification_18112019.pdf

³ Insolvency and Bankruptcy (Application to Adjudicating Authority for Insolvency Resolution Process for Personal Guarantors to Corporate Debtors) Rules, 2019 and Insolvency and Bankruptcy (Application to Adjudicating Authority for Bankruptcy Process for Personal Guarantors to Corporate Debtors) Rules, 2019.

⁴ Article 32 of the Constitution

⁵ Article 139A of the Constitution

⁶ *Lalit Kumar Jain vs. Union of India and Ors.* (21.05.2021 - SC): MANU/SC/0352/2021.

“NCLT would be able to consider the whole picture, as it were, about the nature of the assets available, either during the corporate debtor’s insolvency process, or even later; this would facilitate the CoC (Committee of Creditors) in framing realistic plans, keeping in mind the prospect of realizing some part of the creditors’ dues from personal guarantors.”

It may seem obvious on the face of it that if a debtor fails to repay debt to the creditor, the burden falls on the guarantor to pay the amount *i.e.*, when a Resolution Plan⁷ is approved by NCLT – it does not *per se* operate as a discharge of the guarantor’s liability. As to the nature and extent of the liability, much would depend on the terms of the guarantee itself. SC concluded by holding that the release or discharge of a principal borrower from the debt owed by it to its creditor, by an involuntary process, *i.e.*, by operation of law, or due to liquidation or insolvency proceeding, does not absolve the surety/guarantor of their liability, which arises out of an independent contract.

Conclusion

In view of the notification,⁸ which is upheld by the SC, creditors can approach NCLT which will be the adjudicating authority against personal guarantors. Earlier, they had to approach the Debt Recovery Tribunal (“**DRT**”) for actions against assets of guarantors⁹ This will help maximising value of assets of the corporate debtor, promotion of credit markets and better encourage entrepreneurship due to the effective framework of NCLT for timely resolution under the Code.

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⁷ Section – 31 of Insolvency and Bankruptcy Code, 2016.

⁸ S.O. 4126 (E) issued by the Ministry of Corporation Affairs, Central Government.

⁹ *State Bank of India vs. V. Ramakrishnan and Ors.* (14.08.2018 - SC): MANU/SC/0849/2018.