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Position of a Personal Guarantor under the Insolvency and Bankruptcy Code

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INTRODUCTION

The concept of contract of guarantee revolves around the principle that a Personal guarantor shall perform the promise or discharge the liability of the principal debtor towards a creditor, in the event, such principal debtor has failed to perform its promise or discharge its liability.

[1]

The Insolvency and Bankruptcy Code, 2016 ("**IBC**") defines a personal guarantor as an individual who is the surety under a contract of guarantee to a corporate debtor.

[2]. IBC was promulgated in August 2016. However, the provisions of IBC pertinent to insolvency resolution process of personal guarantors to corporate debtors were not.

PERSONAL GUARANTOR VIS-À-VIS CIRP AGAINST A CORPORATE DEBTOR

The IBC provides rights to a creditor to initiate corporate insolvency resolution process ("**CIRP**") against both the debtor and the guarantor.

The Supreme Court of India ("**Supreme Court**") in the matter of *State Bank of India v. V. Ramakrishnan and Others* ("**Ramakrishnan judgment**") [3] concluded that in a contract of guarantee, the liability of the guarantor and that of the principal debtor are co-extensive, and therefore, the creditor can simultaneously sue either the corporate debtor, the guarantor, or both, in no particular order.

Relying on the recommendation in the report of the Insolvency Law Committee ("**ILC**") dated 26 March, 2018, and post the Ramakrishnan judgment, the Government amended Section 14(3) of the IBC which provided that the period of moratorium operating against the corporate debtor shall not be applicable to a guarantor in a contract of guarantee to a corporate debtor.

Section 60(2) of the IBC provides that if the CIRP or liquidation of a corporate debtor is pending before the National Company Law Tribunal ("**NCLT**"), any application pertaining

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We regularly handle technically challenging and complex multi-jurisdictional matters. Our team is spearheaded by one of the highly recognised lawyers with extensive experience in international dispute resolution and strong government and diplomatic backgrounds. This experience gives us the deepest understanding of the key decision points that are critical in navigating complex & complicated matters and managing government regulations.

to the CIRP, liquidation or bankruptcy of a guarantor of such corporate debtor is liable to be filed before the same NCLT.

Section 60(3) of the IBC provides that in the event CIRP or liquidation or bankruptcy proceeding of a corporate guarantor or a personal guarantor of the corporate debtor is pending before any court or tribunal, it shall stand transferred to the same NCLT dealing with CIRP or liquidation proceeding of such corporate debtor. Insolvency proceedings can be initiated against any personal guarantor under Section 95 of the IBC by filing an application before the NCLT.

STANDPOINT OF A PERSONAL GUARANTOR UNDER THE NEW INSOLVENCY RULES

The Ministry of Corporate Affairs notified the 2019 Rules which became effective from 1st December 2019. Under the 2019 Rules, Section 2(e) of the IBC was notified which made Part III of IBC separately applicable to personal guarantors to corporate debtors. As a result of the same, a creditor can initiate CIRP against a personal guarantor before the Debt Recovery Tribunal. The notification of the 2019 rules triggered the initiation

of CIRP against many personal guarantors to corporate debtors. This action against the personal guarantors culminated in the 2019 Rules getting challenged before various High Courts across the country.

The Supreme Court finally settled the controversy apropos the position of personal guarantors in *Lalit Kumar Jain v. Union of India and Ors* ("**Lalit Kumar Jain**").^[4] The Supreme Court upheld the validity of the 2019 Rules *inter alia* holding that the intention to insert Section 2(e) and alter Section 60(2) was directed to strengthen the CIRP and IBC keeping in mind the intrinsic connection between a personal guarantor and a corporate debtor. It further held that an approval of a resolution plan does not necessarily discharge a personal guarantor of its liabilities under the contract of guarantee.

PERSONAL GUARANTOR'S RIGHT OF SUBROGATION UNDER THE IBC

The right of subrogation is an equitable right available to a guarantor as it steps into the shoes of the creditor upon performing the obligations on behalf of the principal debtor, and is invested with all the rights that

the creditor possessed as against the principal debtor^[5]. Therefore, the guarantor upon performing the obligations of the principal debtor must be indemnified. Nonetheless, under the IBC, the personal guarantor does not possess this right to proceed against the corporate debtor once the personal guarantor has paid the corporate debtor's debts to the creditors.

In *Lalit Mishra and Others v. Sharon Bio Medicine Limited* ("**Lalit Mishra**")^[6], NCLAT held that the guarantors cannot exercise the right of subrogation conferred upon them under contract law, since the proceedings under IBC are not recovery proceedings which was further affirmed by the Supreme Court^[7]. This stance of the Supreme Court was also affirmed in the case of *Committee of Creditors of Essar Steel Ltd. v. Satish Kumar Gupta* ("**Essar Steel**")^[8].

CONCLUSION

The Ramakrishnan judgment along with Lalit Kumar Jain paved the way for initiation of insolvency proceedings against the personal guarantor to a corporate debtor under the IBC, thus protecting the rights of the creditors.

It is trite that, a guarantor, as a right under the law of equity and natural justice can recover the quantum of money paid on behalf of the principal debtor.

However, the rulings of Indian courts *viz.* Lalit Mishra and Essar Steel will shake the confidence of a personal guarantor who are generally the promoters/directors of a corporate debtor to act as a surety to the corporate debtor.

REFERENCES

[1] S. 126, Indian Contract Act, 1872.

[2] S. 5 (22), Insolvency and Bankruptcy Code, 2016.

[3] AIR 2018 SC 3876.

[4] (2021) 9 SCC 321.

[5] S. 140, Indian Contract Act, 1872.

[6] [2019] 148 CLA 154

[7] Civil Appeal No.1603 of 2019

[8] 2019 (16) SCALE 319

NEWS AND UPDATES

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DOMESTIC ARBITRATION

MERE USE OF THE WORD 'ARBITRATION' IN HEADING OF AGREEMENT DOES NOT INFER EXISTENCE OF ARBITRATION AGREEMENT BETWEEN THE PARTIES

The Delhi High Court ("DHC") in *Foomill Pvt Ltd. v. Affle (India) Ltd.* has held that the mere use of word 'Arbitration' in the heading in the Clause of Agreement would not lead to the inference that there exists an agreement between such parties seeking resolution of disputes through arbitration. The Court referred to the observations of DHC in *Avant Garde Clean Room & Engg.*

Solutions Pvt. Ltd. v. Ind Swift Limited where it was held that merely using the word 'arbitration' will not make it a valid arbitration clause while the main body of the clause provides for the jurisdiction of the courts.

A PARTY CANNOT BE PERMITTED TO RETAIN PERFORMANCE SECURITY AFTER IT HAD ACKNOWLEDGED DUE PERFORMANCE OF A CONTRACT

The DHC in the case of *Bharat Sanchar Nigam Ltd. ("BSNL") v. Teracom Ltd.* has upheld the arbitral award which directed BSNL to refund the

amount recovered by it from invocation of a performance bank guarantee. The DHC observed that since no claim regarding failure to perform obligations under the contract was made by BSNL, they could not be permitted to retain performance security after it had acknowledged due performance of the contract by Teracom.

THE ARBITRAL TRIBUNAL CANNOT REDUCE THE LIQUIDATED DAMAGES ON 'GUESS WORK'

The DHC in *Haryana Vidyut Prasaran Nigam Ltd. v. M/s Cobra*

RECENT UPDATE

Our Managing Partner, Mr. Sonal Kumar Singh, has been ranked by Forbes India Legal Powerlist 2021 in association with Legitquest as one of the Top 50 Managing Partners (above 10 years experience) and one of the Top 100 Individual Lawyers (above 10 years experience) in the category of ADR – Arbitration/Mediation and Litigation.

Our Partner, Mr. Anish Jaipuriar, was ranked as one of the Top 100 Individual Lawyers (below 10 years experience) in the category of Corporate and Commercial- Joint Venture, M&A, PE and VC.

Our Partner, Mr. Anish Jaipuriar, is an international recipient of the prestigious Lex Falcon Awards conferred at the LexTalk World Global Hybrid Conference, held at Dubai, Deira, UAE.

Instalaciones Y. Services S.A. & M/s Shyam Indus Power Solution Pvt. Ltd. held that the arbitral tribunal cannot reduce the liquidated damages on 'guesswork' if it finds that it is a pre-estimated damages and it is not possible to quantify the damages. The Court held that once the arbitrator finds that the employer has suffered substantial losses due to the fault of the contractor and the contract provides for liquidated damages which were genuine pre-estimate of the loss as the quantification of the claim is not possible, then the arbitrator cannot reduce the amount of the damages on a guesswork for the reason that some of the losses could be quantified.

STIPULATING A CONDITION OF 'AS IS WHERE IS' BASIS IN A LICENSE AGREEMENT DOES NOT ABSOLVE THE CONTRACTING PARTIES TO MAKE A DISCLOSURE ABOUT THE LICENSE PREMISES WHICH IS OTHERWISE NOT EVIDENT ON VISUAL INSPECTION

Ltd ("ITDC") v. Bougainvillea Multiplex & Entertainment Centre

Pvt Ltd upheld the award of an arbitral tribunal that ruled that handing over the premises on an 'as is where is basis' did not absolve ITDC of its obligation to ensure that the premises were fit for the purpose for which they were licensed. The DHC further observed that Indian Evidence Act, 1872 does not strictly apply to the proceedings before the Arbitral Tribunal.

THE ADJUDICATING AUTHORITY CANNOT DECIDE THE 'AMOUNT OF DEBT' AT THE STAGE OF ADMISSION OF A SECTION 7 APPLICATION OF THE IBC

The National Company Law Appellate Tribunal in *Rajesh Kedia v. Phoenix ARC Private Limited* has held that it is not within the domain of the adjudicating authority to decide the "amount of debt" at the stage of admission of an application under Section 7 of the IBC. The tribunal observed that the only requirement for admission is that the minimum outstanding debt should be more than the threshold amount provided for under the IBC.

CORPORATE INSOLVENCY RESOLUTION PROCESS

(CIRP) COSTS TO INCLUDE THE WAGES AND SALARIES PAYABLE TO THE WORKMEN AND EMPLOYEES WORKING DURING THE CIRP

The Supreme Court in the case of *Sunil Kumar Jain and Ors. v. Sundaresh Bhat and Ors.* Has held that the CIRP costs would include the wages and salaries payable to the workmen of the Corporate Debtor who were actually working during the CIRP. The Supreme Court observed that the dues payable to workmen are given priority under the waterfall mechanism of the IBC.

The Supreme Court further observed that while considering the claims of the employees and workmen, being the appellants herein, what needs to be established is that firstly the Corporate Debtor was a going concern and secondly the workmen and the employees actually worked during the CIRP. The wages and salaries of the workmen and employees who have not worked during the CIRP would not be automatically included under the waterfall mechanism under Section 53(1)(a) of the IBC.

CORPORATE UPDATES

OPERATIONAL GUIDELINES "SECURITY COVENANT MONITORING" USING DISTRIBUTED LEDGER TECHNOLOGY (DLT) FOR AND

The Securities and Exchange Board of India ("SEBI") vide circular no. SEBI/HO/MIRSD/CRADT/CIR/P/2022/38 dated March 29, 2022 issued the following guidelines for usage of Distributed Ledger Technology (DLT):

SEBI vide Circular numbered SEBI/HO/MIRSD/MIRSD_CRADT/CIR/P/2021/618 dated August 13, 2021 had specified the manner of recording of charges by Issuers and manner of monitoring by Debenture Trustees (DTs), Credit Rating Agencies, etc. Accordingly, with effect from April 01, 2022, the recording of asset details (and their verification), allotment, listing and payment of interest or redemption would be available in the system.

A system generated unique identifier (Asset ID) shall be allotted for each asset offered by Issuer as security for the non-convertible securities. The format for unique Asset ID would be generated as provided in Annexure-I of the instant circular.

The DLT system would also provide an alert to the Issuer in order to ensure effective asset creation as well as tracking. The DT would also have an appropriate validation based on the parameters in Annexure-II of the instant circular. Initially, movable assets, current assets and any other asset of similar nature would be tracked at the portfolio level and no specific parameters for the underlying assets would be captured.

CLARIFICATION ON APPLICABILITY OF REGULATION 23 OF SEBI (LISTING OBLIGATIONS AND DISCLOSURE REQUIREMENTS) REGULATIONS, 2015 ("LODR REGULATIONS") IN RELATION TO RELATED PARTY TRANSACTIONS ("RPT")

The SEBI vide Circular No.: SEBI/HO/CFD/CMD1/CIR/P/2022/40 dated March 30, 2022 issued clarifications regarding on applicability of regulation 23 of the SEBI LODR Regulations, 2015 in relation to Related Party Transactions.

Regulation 23 of LODR Regulations was amended vide notification dated November 9, 2021, *inter-alia*, enhancing the scope of related party, RPTs and

the materiality threshold for seeking shareholder approval. The following clarifications and guidance for smooth implementation of the amended Regulation 23 of the LODR Regulations:

RPTs approved by the audit committee and shareholders prior to April 1, 2022, will not be required to seek fresh approval from shareholders.

In accordance with Regulation 23(8) of the LODR Regulations, a RPT approved prior to April 01, 2022 which continues beyond such date and becomes material as per the revised materiality threshold shall be placed before the shareholders in the first General Meeting held after April 1, 2022.

This Circular shall come into force with effect from April 1, 2022.

MASTER CIRCULAR ON BASEL III CAPITAL REGULATIONS

Reserve Bank of India ("RBI") vide RBI/2022-23/12 dated April 1, 2022 has consolidated the prudential guidelines on Basel III capital adequacy issued to the banks till June 30, 2015. Basel III reforms are the response of Basel Committee on Banking Supervision (BCBS) to improve the banking sector's ability to absorb shocks arising from financial and economic stress, whatever the source, thus reducing the risk of spill over from the financial sector to the real economy.

The implementation of Basel III capital regulations were initiated on April 1, 2013 and were completed on October 1, 2021. Banks have to comply with the regulatory limits and prescribed minimums on an ongoing basis. It has been decided that Scheduled Commercial Banks ("SCB") operating in India shall maintain a minimum total capital ("MTC") of nine (9) per cent of total risk weighted assets ("RWA") i.e. the Capital to Risk Weighted Assets ("CRAR").

GUIDELINES FOR ESTABLISHMENT OF DIGITAL BANKING UNITS (DBU)

RBI vide RBI/2022-23/19 dated

April 7, 2022 has notified the establishment of DBUs. These guidelines are applicable to all Domestic Scheduled Commercial Banks (excluding Regional Rural Banks, Payments Banks and Local Area Banks) and will come into effect from the date of issue of the Circular.

A Digital Banking Unit (DBU) is a specialised fixed point business unit / hub housing certain minimum digital infrastructure for delivering digital banking products & services as well as servicing existing financial products & services digitally, in both self-service and assisted mode.

REVISION OF UPI LIMITS IN PUBLIC ISSUE OF EQUITY SHARES AND CONVERTIBLES

SEBI vide Circular no. SEBI/HO/CFD/DIL2/CIR/P/2022/4 dated April 5, 2022 revised UPI Limits in public issue of equity shares and convertibles. It has been decided that all Individual Investors applying in Public Issues where the application amount is up to 5 lakhs would use UPI and shall provide their UPI ID in the bid-cum-application form submitted with any of the entities specified in the circular.

This circular shall come into force for Public Issues opening on or after May 01, 2022.

COMPANIES (ACCOUNTS) SECOND AMENDMENT RULES, 2022

Ministry of Corporate Affairs vide its notification dated March 31, 2022 has notified the Companies (Accounts) Second Amendment Rules, 2022 in which it has stated that the proviso to rule 3(1), for the figures, letters and words "1st Day of April, 2022", the figures, letters and words "1st Day of April, 2023" shall be substituted and the proviso to rule 12(1B), for the figures, letters and word "31st March, 2022", the figures, letters and word "31st May, 2022" shall be substituted.

OTHER UPDATES

ANY MATERIAL ALTERATION IN THE TERMS OF THE ORIGINAL CONTRACT WOULD GIVE THE OTHER PARTY THE OPTION TO NOT PERFORM THE SAID ORIGINAL CONTRACT AND SHALL NOT AMOUNT TO ABANDONMENT

The Supreme Court in the case of *Shripati Lakhu Mane v. The Member Secretary, Maharashtra Water Supply Board & Ors.*, held that the appellants' refusal to perform the obligations under the work-order, can be termed as breach of contract and not abandonment. As per S. 67 of the Indian Contract Act, 1872, if any promisee neglects or refuses to afford the promisor reasonable facilities for the performance of his promise, the promisor is excused by such neglect or refusal. Such a refusal may entitle the other party to sue for breach or rescind the contract and sue on a quantum meruit for the work already done.

RELIEFS IN A SUIT WHICH SEEKS TO FRUSTRATE THE DEFENDANTS FROM INITIATING LEGAL ACTION AGAINST THE

PLAINTIFF CAN BE A GROUN FOR ALLOWING AN APPLICATION FOR REJECTION OF PLAINT

The Supreme Court in the case of *M/s. Frost International Limited v. M/s. Milan Developers And Builders (P) Limited & Anr* held that on a holistic reading of the plaint and on consideration of the reliefs sought by the plaintiff, the said reliefs are barred by law in as much as no plaintiff can be permitted to seek relief in a suit which would frustrate the defendants from initiating a prosecution against plaintiff or seeking any other remedy available in law.

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AWARDS & RECOGNITIONS



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