

From Chairperson's Desk

Personal Guarantors under IBC: Unlocking the Value

The Insolvency and Bankruptcy Code, 2016 (IBC/ Code) is aimed to resolve corporate persons and individuals in stress in a time-bound manner for value maximisation. The provisions for resolving corporate persons were notified in 2016, and in the year 2018, the Code was amended to trifurcate the individuals into these categories: personal guarantors (PGs) to corporate debtors (CDs); partnership firms and proprietorship firms; and other individuals, to enable implementation of the provisions for resolution of individuals in a phased manner.

Section 128 of the Indian Contract Act, 1872 stipulates that the liability shared between a principal debtor and a surety is co-extensive, barring any contract to the contrary. This principle underscores that the extent of liability is tied directly to the principal debt amount. Since insolvency proceedings of CD and PG are interwoven pursuant to a common debt, the Central Government, in November, 2019, notified the provisions related to the insolvency resolution and bankruptcy process for the PGs to CDs. This afforded creditors the flexibility to initiate proceedings against both CDs and PGs concurrently, enhancing the recovery prospects for the stakeholders and ensuring a synergized approach to insolvency resolution. The Hon'ble Appellate Authority in the matter of *SBI v. Athena Energy Ventures (P) Ltd.* also held that the IBC permits concurrent initiation of corporate insolvency resolution process (CIRP) against a principal borrower and its corporate guarantor.

In case of insolvency and bankruptcy proceedings of the PGs to CDs, where the related corporate process is undergoing, the Adjudicating Authority (AA) is the National Company Law Tribunal (NCLT) in terms of Section 60 of the Code. Both the PG and the creditor can file an application, either themselves or through Resolution Professional (RP), before the AA to initiate insolvency resolution process of PGs. Interim moratorium imposes only on legal action in relation to all the debt owed by the PG. Subsequently, the RP appointed by the AA, examines the application preferred by the PG or creditor and submits a report to the AA. The AA adjudicates to admit or reject the application. On admission, RP calls for claims from the creditors and collaborates with the PG to devise a debt repayment plan. This proposed plan necessitates the majority creditors' approval, failure to achieve this may result in the PG's bankruptcy proceedings.

Since the notification came into effect, rights and responsibilities of PGs under the IBC have been challenged in various High Courts and the Hon'ble Supreme Court (SC). In 2021, Hon'ble SC in *Lalit Kumar Jain v. Union of India & Ors.* upheld the legality of aforesaid notification and clarified that approval of a resolution plan relating to a CD does not operate so as to discharge the liabilities of PGs to CDs. Thereafter, concerning the procedural aspect, several writ petitions were again filed before various High Courts and the Hon'ble SC challenging the constitutionality of the PG to CD provisions on the ground that impugned provisions did not adhere to the due process of law and are in contravention of Articles 14 and 21 of the Constitution. In deciding all the petitions, the Hon'ble SC in the matter of *Dilip B. Jiwrajika v. Union of India & Ors.* upheld the constitutionality of provisions of sections 95 to 100 related to PGs and *inter alia* stated that:

- (i) No judicial adjudication, including determination of 'jurisdiction facts', is involved at the pre-admission stages envisaged in sections 95 to 99 of the IBC;
- (ii) The RP serves a facilitative role of collating all the facts relevant to the examination of the application for the commencement of the insolvency resolution process. The report to be submitted to the AA is recommendatory in nature on whether to accept or reject the application;

- (iii) The RP may exercise the powers vested under section 99(4) of the IBC for the purpose of examining the application for insolvency resolution and to seek information on matters relevant to the application in order to facilitate the submission of the report recommending the acceptance or rejection of the application;
- (iv) There is no violation of natural justice under sections 95 to 100 of the IBC as the debtor is not deprived of an opportunity to participate in the process of the examination of the application by the RP;
- (v) The AA must observe the principles of natural justice when it exercises jurisdiction under section 100 for the purpose of determining whether to accept or reject the application; and
- (vi) The purpose of the interim-moratorium under section 96 is to protect the debtor from further legal proceedings.

This judgement has cleared the roadblocks for insolvencies involving PGs, providing relief for lenders whose petitions for insolvency proceedings against PGs were getting stuck in various judicial forums due to the legal challenge of various provisions. This *inter-alia* facilitates a more holistic resolution of the CD and its PGs aligning with the IBC's mandate for value maximization. With 2,467 insolvency applications filed against PGs, involving debts exceeding ₹ 1.71 lakh crore as of December, 2023, the clarification of the SC on the obligations of these guarantors under the IBC significantly enhances creditors' chances of recovering these dues.

To improve the efficiency and transparency of insolvency resolution process for PGs, the Insolvency and Bankruptcy Board of India (IBBI/ Board) has taken regular measures from time to time. Recently, it has taken three key measures. *Firstly*, same RP has been allowed to manage both insolvency resolution process of PG and CIRP of CD for enhanced harmonization of both the processes. *Secondly*, RP is mandated to share his recommendations with both debtors and creditors in order to facilitate informed decision-making among stakeholders. *Lastly*, RP is mandated to conduct creditors' meetings for all PG cases to ensure that the collective voice of creditors is factored into the resolution process, providing a more holistic perspective on the repayment plan.

It is seen that CIRP proceedings are often delayed due to excessive litigation. The debtors' attempt to prolong the admission or the resolution process leads to erosion in CD's value. Paradoxically, this prolongation amplifies the liabilities of PGs, and hence it is in the interest of the debtors to cooperate during the resolution of the CD.

While the CD is reorganized during CIRP, the insolvency resolution process for the PGs prioritises debt restructuring. This is the opportunity the IBC affords over outright bankruptcy, with bankruptcy serving as a last resort should the debtor's repayment plan falter. By co-operating in the process and submitting a repayment plan for approval by creditors, debtors can effectively discharge their debt liabilities instead of initiation of their bankruptcy process.

In conclusion, the concurrent proceedings of insolvency processes for CDs and their PGs are in line with the legislative intent of the Code. This approach not only facilitates a more comprehensive resolution strategy but also aligns with the Code's objectives of expedited resolutions and value maximization. The creditors must take this key development into their stride and file applications for initiation of the PG cases, to unlock the upside potential for resolution and also to further enhance their realization through these proceedings.

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