Personal Guarantors under IBC : A Critique and Unresolved Issues

INTRODUCTION

On May 21, 2021, the division bench of the Hon'ble Supreme Court in the case of *Lalit Kumar Jain* v. *Union of India & Ors [2021] 127 taxmann.com 368 (SC).* decided the *vires* and the validity of the notification dated 15.11.2019 issued by the Central Government ("the impugned notification"). The government vide this notification appointed 1st December 2019 as the date of commencement to enforce certain provisions of Part III only with respect to the personal guarantors to the corporate debtor. Additionally, it also notified rules and regulations for Insolvency and Bankruptcy of Personal guarantors. All the writ petitions and transfer case applications under various Courts challenging the extent and scope of powers conferred upon the government with regard to enforcement of selective application of provisions under Section 1(3) of the IBC vide its impugned notification were arrayed in the instant matter.

CONTENTIONS ON BEHALF OF PETITIONERS'

Firstly, the Petitioners contended that Section 2(e) was already enforced with retrospective effect by Act 8 of the 2018 Amendment Act, which altered it by sub-categorizing three categories of corporate debtors; differentiating personal guarantors from partnership and proprietorship firms and other individuals. Moreover, Section 2(g) deals with individuals other than persons referred in Section 2(e). But to the contrary, the impugned notification enforces Part III wrt to only personal guarantors, which in fact stand explicitly excluded from the definition of individuals and not once there has been any mention of them under Part III of the Code, not even in the title of Part III. Consequently, conjoint readings of Section 2(e) with Section 2(g) along with Part III show that personal guarantors stand explicitly excluded from the definition of individuals and Part III doesn't apply to them.

Secondly, the major contention of the Petitioners is that the Central Govt. purportedly enforced Part III to personal guarantors and the impugned notification is *ultra vires.* The impugned notification by the executive is enforced without any legislative guidance resulting in the constitutional usurpation of legislative power due to excessive delegation. As under Section 1(3), the Govt. could have only appointed different dates to implement different provisions, but it can not selectively enforce Part III to one particular sub-category. Reliance was placed on Privy Council in the *Burah , Re Delhi Laws Act , Hamdard Dawakhana* v. *Union of India* AIR 1965 SC 1167, and *Vasu Dev Singh* v. *Union of India* [2006] 12 SCC 253 case. Henceforth, the notification is in the exercise of conditional legislation, therein the government is not conferred with the power of modification to limit and impose the conditions when provisions under it do not specifically

or even separately deal with personal guarantors and only deal with individuals and partnership firms which does not include the personal guarantors.

Thirdly, notification creates two self-contradictory legal regimes by which creditors can go under IBC as well as the PTI, 1909 and the PIA, 1920 as Section 243 of the Code which repeals these laws is yet to come into force. On top of that, the notification enables the financial creditors to unjustly benefit themselves at the cost of personal guarantors as they can claim the full amount under insolvency proceedings against personal guarantors to corporate debtors without accounting for the already claimed amount.

Fourthly, that there is presence of arbitrariness as notification lacks reasonable classification due to no exercise of intelligible differentia and additionally provides a single procedure for the insolvency resolution process of the personal guarantor, treating operational and financial creditors by collapsing the classification in Part II of the Code. To substantiate, reliance was placed on the *Swiss Ribbons (P.) Ltd.* v. *Union of India* [2019] 101 taxmann.com 389 / 152 SCL 365 (SC) case. They reasoned that while good faith and knowledge of the existing conditions on the part of a legislature are to be presumed, it cannot be carried to the extent of always holding that there must be some undisclosed and unknown reasons for subjecting certain individuals or corporations.

Lastly, the impugned notification is not severable as with enforcement of Section 96 and Section 101 of the Code an interim moratorium would tantamount to halting of CIRP ongoing against the corporate debtor due to stay in any proceedings with respect to all the debts.

CONTENTIONS ON BEHALF OF RESPONDENTS

It was contended that Part III of the Code applies to personal guarantors under Section 2(e), which are indeed individuals like the other individuals under Section 2(g). Respondents reasoned that the intention of the 2018 amendment, which sub-categorized the generic S 2(e) was required to ensure a synchronized and unified system of resolution for corporate debtors and their personal guarantors. It was also argued that the notification brought the two similar classes of guarantors owing to the nature of the relationship with the CD under the purview of code i.e. the Personal guarantor and the Corporate guarantor. As against earlier when code by application of part II only kept corporate guarantor under its purview. Moreover, a conjoint reading of Section 2(e) and Section 2(g), wherein the latter says *individuals other than persons under clause (e)* itself accepts that personal guarantors are sub-set of individuals and are classified separately only to facilitate the resolution process of CD and their personal guarantors before a single forum under Section 60(2). It was also submitted that Section 60 and 179 of the code, in addition to S 1(3), 2, 3(23), 5(22), 14(3), and 31(1) are also indicative of the aforementioned premise.

It was then contended that the petitioner's interpretation is unduly narrow as against the accepted view of purposive interpretation discussed in the *Arcelor MittalIndia (P.) Ltd.* v. *Satish Kumar Gupta* [2018] 98 taxmann.com 95 / 150 SCL 254 (SC) case, which acknowledges the legislative intent. As per the latter, Section 1(3)allows phased and selective enforcement of provisions under the code. Enforcement only with respect to the personal guarantor, also did not alter the character of the code. Such phased enforcement is valid as per the landmark case of *Rolling Mills* and *Bishambar Singh .* Further relying on the case of *Lalit Narayan and Javed* , it was contended that the legislature has the discretion to clothe the duty of enforcement to the executive. In response to the contentions of it being conditional legislation, the learned counsels argued that the said section which allows the government to appoint different dates for different provisions, in the first place doesn't need a characterization as the line between conditional and delegation legislation often gets blurred. Additionally, enforcement with certain modifications in presence of sufficient legislative guidance like in the present case does not amount to excessive delegation.

With regards to the contentions that the presence of Section 243 allows dual regime, the respondents reasoned that Section 238 of the Code overrides all the other laws, thereby leaving no need to explicitly repeal section 243.

Learned counsels also clarified that the application of the impugned notification will not allow unjust enrichment of creditors by allowing them to recover more than what's owed, owing to safeguards under the settled principles of the contract act and IBC. They also highlighted that insolvency under Part III ensures the benefits of an interim moratorium to the guarantors.

JUDGEMENT

The Hon'ble Court in its judgment upheld the notification by adopting a systematic, structural, and purposive interpretation of Section 1(3) of the Code contrary to the literal interpretation of the Section as contended by the Petitioners. This is because first, the bench agreed that the Central Government has the discretionary power to implement provisions in a phased manner. Thus, while interpreting Sec. 1(3) and keeping in mind the legislative intent behind it, the Court ruled that any limitations on the power of the Central Government will not exist and the notification issued will not be substantively *ultra vires*, in turn, refuting the argument of the Petitioners that Sec. 1(3) is conditional legislation.

With regards to Section 2(e), the Bench accepted the argument of the Respondent that Section 2(e) altered with Section 60(2) shall establish the intent to extend the provisions of the Code to personal guarantors. Insofar as the question of enforcement of Section 243 is concerned, the Bench accepted the argument and reasons of the Respondents. Furthermore,

held the position taken in *V. Ramakrishnan* v. *Dy. CIT [2019] 104 taxmann.com 389 / 263 Taxman 145 (Mad.)* case that the liability of personal guarantors is co-extensive with that of corporate debtors and hence an involuntary act of approval of resolution plan with the application of Section 31 does not automatically discharge the liability of the PG.

CRITICAL ANALYSIS

In the humble views of the authors, though the overall conclusion reached in the discussed judgment upholding the constitutionality of the 15.09.2019 notification is apt, there exist some issues which were either inadequately dealt with or completely left open-ended. They are with regards to:

1. The contentions pertaining to Article 14

The Hon'ble Court did not deal with determining the constitutional validity of the notification when faced with an Article 14 challenge. The judgment was silent on one of the contentions of the Petitioners that the notification treats financial and operational creditors on the same footing by providing a single procedure for insolvency. Perhaps the Court was also supposed to apply the dual test, namely, the lack of reasonable classification and presence of manifest arbitrariness to elucidate on the fact that due to dynamics, conditions, and factors involved in the insolvency and bankruptcy of individuals and those who have extended personal guarantee to corporate debtors are likely to be different. Moreover, the personal guarantors form the basis of the credit lending regime. Therefore, the implementation of Part III of the Code in a phased manner should be considered as a legislative judgment which has been decided upon after looking at the prevailing circumstances and the suggestions received from the working committee rendering this classification rational and based upon intelligible differentia.

2. Procedural requirements of the delegated legislation

They are not duly complied with as all the rules and regulations pertaining to IBC are mandatorily required to be laid down before the parliament. However, the rules and regulations relating to personal guarantors have not been laid down in the parliament until now.

3. Absurdity created by Section 96 and Section 101

The effect of interim moratorium under Section 96 or under Section 101, was left undiscussed. The said sections are applicable in respect of any debt due, and the protection of moratorium under these stays on the legal proceedings against the debt and not the debtor. Since this debt would include the debt of the Corporate Debtor as well, all the legal

proceedings with respect to the said 'debt' against Corporate Debtor, including the corporate insolvency resolution process against the Corporate Debtor, will be impacted as the moratorium period and will stay all the ongoing proceedings against the CD. Authors however believe that legal technicalities should not be allowed to override the objective of the code, but they do believe that this absurdity shall be catered to by a clarificatory amendment.

4. Inadequate measures to prevent double-dipping

There is no clear position of law as to whether, after the approval of the Resolution plan but before it actually pays off, the creditors are allowed to proceed against the PG for the entire amount or the balance amount. So at such a stage, either the creditor may unjustly enrich if allowed to proceed for the entire amount or the resolution applicant may absurdly benefit. And the PG will miserably suffer as at such a stage the law takes away their subrogation rights and leaves them remediless.

5. Threshold disparity leading to harassment

The application of impugned notification with no consideration to the disparity between the threshold requirements for initiation of CIRP against CD and PG which is Rs. 1 crore and Rs. 1000 respectively is sheer harassment of guarantors and CIRP for such small amounts may absurdly halt the CIRP against the CD owing to the application of Section 101.

To conclude, the authors believe that the judgment settles the dust pertaining to the constitutionality of the impugned notification to a large extent, however, the loopholes and unattended questions associated with it shall be catered as soon as possible.

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