

Insolvency and Bankruptcy Board of India
7th Floor, Mayur Bhawan, Connaught Place, New Delhi - 110001

22nd May, 2021

Subject: Judgment¹ dated 21st May, 2021 of the Hon’ble Supreme Court of India in the matter of Lalit Kumar Jain Vs. Union of India & Ors. [Transferred Case (Civil) No. 245/2020 and other writ petitions]

The Central Government, vide notification dated 15th November, 2019, brought into force provisions relating to the personal guarantors (PGs) to CDs with effect from 1st December, 2019. Several petitions were filed in different High Courts challenging the said notification and related Rules and Regulations. While directing transfer of petitions from High Courts to itself, the Supreme Court noted that the Code was at a nascent stage and it was better that the interpretation of the provisions is taken up by it to avoid any confusion and to authoritatively settle the law. However, during the course of submissions, the parties stated that the challenge would be confined to the impugned notification. While dismissing the petitions, the Supreme Court held: (i) the notification dated 15th November, 2019 is legal and valid; and (ii) approval of a resolution plan relating to a CD not operate as a discharge of the liabilities of PGs the CD. It also made some important findings and observations as under:

Sl. No.	Issue	Ruling	Para / Page No.
1	Objective and institutional framework under the Code.	(a) The Code has been hailed as a major economic measure, aimed at aligning insolvency laws with international standards. The aim of the Code is to: (i) promote entrepreneurship and availability of credit; (ii) ensure the balanced interests of all stakeholders and (iii) promote time-bound resolution of insolvency in case of corporate persons, partnership firms and individuals. (b) The highlight of the Code is the institutional framework it envisions. These institutions and structures are aimed at promoting corporate governance and also enable a time bound and formal resolution of insolvency.	58/35 60/38
2	Gradual implementation of Code.	(a) The method adopted by the Central Government to bring into force different provisions of the Code has a specific design: to fulfil the objectives underlying the Code, having regard to its priorities. ... The Central Government followed a stage-by-stage process of bringing into force the provisions of the Code, regard being had to the similarities or dissimilarities of the subject matter and those covered by the Code.	81/61

¹ Prepared by Legal Affairs Division for the sole purpose of creating awareness and must not be used as a guide for taking or recommending any action or decision, commercial or otherwise. One must do its own research or read the original text of the judgment or seek professional advice, if it intends to take any action or decision using the material covered here.

	<p>(b) Having regard to the fact that section 2 brought all three categories of individuals within one umbrella class as it were, it would have been difficult for the Central Government to selectively bring into force the provisions of Part–III only in respect of PGs. The Central Government heeded the reports of expert bodies which recommended that PGs to CDs facing insolvency process should also be involved in proceedings by the same adjudicator. Consequently, the 2018 Amendment Act altered section 2(e) and sub-categorized three categories of individuals, resulting in section 2(e), (f) and (g).</p>	82/62
	<p>(c) Section 60(2) alludes to insolvency resolution or bankruptcy, or liquidation of three categories, namely, CDs, corporate guarantors to CDs and PGs to CDs they apply distributively. It means that insolvency resolution, or liquidation processes apply to CDs and their corporate guarantors, whereas insolvency resolution and bankruptcy processes apply to PGs to CDs who cannot be subjected to liquidation.</p>	88/66
	<p>(d) Discretion to extend an enactment, having regard to the time, area of operation, and its applicability is “limited and almost ministerial function as an agent of the principal Legislature applying the Act to the area at an appropriate time”.</p>	90/67
	<p>(e) The impugned notification, as a consequence of the non obstante clause in Section 238, has the result that if any proceeding were to be initiated against personal guarantors it would be under the Code.</p>	96/70
	<p>(f) There was sufficient legislative guidance for the Central Government, before the 2018 Amendment was made effective, to distinguish and classify PGs separately from other individuals. This is evident from sections 5(22), 60, 234, 235 and unamended section 60.</p>	97/70
	<p>(g) Parliamentary intent is to treat PGs differently from other categories of individuals. The intimate connection between such individuals and corporate entities to whom they stood guarantee, as well as the possibility of two separate processes being carried on in different fora, with its attendant uncertain outcomes, led to carving out PGs as a separate species of individuals, for whom the adjudicating authority was common with the CD to whom they had stood guarantee. The fact that the process of insolvency in Part III is to be applied to individuals, whereas the process in relation to CDs set out in Part II is to be applied to such corporate persons, does not lead to incongruity.</p>	100/73

		(h) On the other hand, there appear to be sound reasons why the forum for adjudicating insolvency processes – the provisions of which are disparate- is to be common, through the NCLT. The NCLT would be able to consider the whole picture, as it were, about the nature of the assets available, either during the CDs insolvency process, or even later; this would facilitate the CoC in framing realistic plans, keeping in mind the prospect of realizing some part of the creditors’ dues from PGs.	100/74
3	Notification dated 15 th November, 2019	(a) The impugned notification is not an instance of legislative exercise or amounting to impermissible and selective application of provisions of the Code. There is no compulsion in the Code that it should, at the same time, be made applicable to all individuals, (including PGs) or not at all. There is sufficient indication in the Code- by sections 2(e), 5(22), 60 and 179 indicating that PGs, though forming part of the larger grouping of individuals, were to be, in view of their intrinsic connection with CDs, dealt with differently, through the same adjudicatory process and by the same forum.	101/74
		(b) The impugned notification inter alia makes the provisions of the Code applicable in respect of PGs to CDs, as another category of persons to whom the Code has been extended.	101/74
		(c) The notification was issued within the power granted by Parliament, and in valid exercise of it. The exercise of power in issuing the Notification under section 1(3) is therefore, not <i>ultra vires</i> and accordingly, is valid.	101/75
4	Liability of a PG to CD in case resolution plan is approved.	(a) Any recourse under section 133 of the Contract Act, 1872 to discharge the liability of the surety on account of variance in terms of the contract, without her or his consent, stands negated. Language of section 31 of the Code makes it clear that the approved plan is binding on the guarantor, to avoid any attempt to escape liability under the provisions of the Contract Act, 1972.	106/77
		(b) The sanction of a resolution plan and finality imparted to it by section 31 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. However, an involuntary act of the principal debtor leading to loss of security would not absolve a guarantor of its liability.	108/78
		(c) Approval of a resolution plan does not <i>ipso facto</i> discharge a PG of a CD of her or his liabilities under the contract of guarantee. 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 his or her liability, which arises out of an independent contract.	111/81

5	Conclusion	(a) The impugned notification is legal and valid.	112-81
		(b) The approval of a resolution plan relating to a CD does not operate so as to discharge the liabilities of PGs to CDs.	112-82
		(c) The writ petitions, transferred cases and transfer petitions are accordingly dismissed in the above terms.	