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Extinguishment of personal guarantee permissible in a resolution plan under IBC.

The National Company Law Appellate Tribunal, Principal Bench, New Delhi ("**NCLAT**") has in the case of ***SVA Family Welfare Trust & Anr v. Ujaas Energy Limited & Ors***[1] *inter alia* held that a resolution plan can contain a clause which extinguishes security interest, such as personal guarantees, after paying compensation to the financial creditor in whose favour such security interest was created. The NCLAT further observed that as a consequence, once a resolution plan has been accepted by the committee of creditors with the requisite majority in its commercial wisdom, the same cannot be impugned before the adjudicating authority.

Brief Facts

By an order dated September 17, 2020, the National Company Law Tribunal, Indore Bench ("**NLCT**") subjected Ujaas Energy Limited ("**Ujaas**") to corporate insolvency resolution process ("**CIRP**") under the provisions of the Insolvency and Bankruptcy Code, 2016 ("**IBC**").

SVA Family Welfare Trust ("**SVA**"), in pursuance of the publication of Form-G, submitted its final resolution plan dated July 5, 2021, read with an addendum dated August 3, 2021 for the resolution of Ujaas before the Committee of Creditors (**"CoC**"). The resolution plan was approved by 78.04% of the CoC on August 30, 2021, following which a letter of intent was issued to SVA. Subsequently, the resolution professional of Ujaas ("**RP**"") filed an interlocutory application No. 190 of 2021 before the NLCT for approval of the resolution plan.

Thereafter, Bank of Baroda, a member of the CoC holding 5.83% of the voting share ("**BoB**"), filed an affidavit objecting to the resolution plan on the basis that it provided for extinguishment of the rights of secured creditors under personal guarantee agreements.

The NCLT passed an Order dated January 6, 2023 *inter alia* holding that – (a) the CoC cannot extinguish the right of a secured creditor to proceed against the personal guarantor of a corporate debtor under the garb of its commercial wisdom; and (b) such a provision in a resolution plan is not only prejudicial to the rights of a secured creditor but is also against the provisions of law. Further, the NCLT noted that BoB had already filed Section 95 applications against the personal guarantors, which were pending adjudication. In view of the above, the NCLT rejected the resolution plan submitted by SVA on the ground that the resolution plan contained a provision for extinguishment of personal guarantees and consequently contravened the provisions of Section 30(2)(e) of the IBC ("**Impugned Order**").

Aggrieved by the Impugned Order, SVA filed an appeal before the NCLAT.

Before the NCLAT, SVA *inter alia* contended that the resolution plan proposed payment of INR 23,82,00,000 (Indian Rupees twenty three crore eighty two lakh only) towards the release of personal guarantees and as such, were to be

[1] Company Appeal (AT) (Insolvency) No. 266 of 2023

extinguished upon the payment of due compensation to the financial creditors. Relying on the decision of the Supreme Court in *Vijay Kumar Jain vs. Standard Chartered Bank and Ors*[2], SVA submitted that a personal guarantee, more often than not provided by erstwhile directors of a corporate debtor, is a security interest under the IBC which can be dealt with in a resolution plan. Further, SVA relied on *Karad Urban Cooperative Bank Limited vs. Swwapnil Bhingardevay and Ors*[3] to contend that the CoC had deliberated and successfully approved the resolution plan. The commercial wisdom of the CoC must be given paramount importance and cannot be interfered with at the instance of a dissenting financial creditor. SVA also submitted that applications filed by BoB under Section 95 of the IBC were merely an afterthought since they were filed after the approval of the resolution plan submitted by them.

The CoC too submitted before the NCLAT that the resolution plan ought not to have been interfered with by the NLCT since the same had been approved with requisite majority. Further, there is no bar under the IBC that restricts the release of personal guarantors from their obligations under personal guarantee agreements.

In support of the Impugned Order, BoB contended that the resolution plan could not have contained any clauses by which personal guarantees executed in its favour could have been extinguished. BoB submitted that it was fully entitled to proceed against the personal guarantors to realise its dues since payment under the resolution plan does not fully cover its dues.

Issue

The only question which arose for the NCLAT's consideration was whether a resolution plan can contain a clause which proposes to extinguish the security interest of a financial creditor by way of a personal guarantee.

Findings and Analysis

The NCLAT allowed the appeal filed by SVA and *inter alia* observed the following:

1. Whilst relying on the ratio in *Lalit Kumar Jain vs. Union of India*[4] to say that the approval of a resolution plan does not *ipso facto* discharge a personal guarantor, a resolution plan could nevertheless contain a clause by which a personal guarantee created in favour of a financial creditor can be extinguished.
2. The resolution plan allocated a value for extinguishment of the personal guarantees, which was accepted by the CoC with a 78.04% majority.
3. The CoC consciously considered and accepted the clauses in the resolution plan for extinguishment of personal guarantees of the financial creditors for compensation offered by SVA for the release of the personal guarantees.
4. The NCLAT also relied on its decision in *Edelweiss Asset Reconstruction Company Ltd vs. Mr. Anuj Jain, Resolution Professional of Ballarpur Industries Ltd. & Ors*[5], which supports the submissions of SVA, and held that the security interest of a dissenting financial creditor by virtue of a personal guarantee executed by an ex-director of the Corporate Debtor can be dealt with in a resolution plan.
5. Barring BoB (which had 5.83% of the vote share), all financial creditors of Ujaas had assented to the relinquishment of security. The commercial wisdom of the CoC in accepting the same was to be given due weightage and could not be impugned at the instance of a dissenting financial creditor.

In view of the above, the NCLAT held that the Impugned Order was unsustainable since the resolution plan submitted by SVA did not contravene the provisions of Section 30(2)(e) of the IBC. Accordingly, the NCLAT directed the NCLT to pass a fresh order for approval of the resolution plan along with necessary directions.

[2] (2019) 20 SCC 455
[3] (2020) 9 SCC 729
[4] [(2021) 9 SCC 321]
[5] Company Appeal (AT) (Ins.) No. 517 & 518 of 2023

Conclusion

The decision of the NCLAT is commensurate with the legal position repeatedly enunciated by the Supreme Court that the commercial wisdom of the committee of creditors is non-justiciable. The finding of the NCLAT appears to have nullified the recovery rights of a financial creditor under an independent contract, i.e., personal guarantee agreements. In a meeting of the committee of creditors, a financial creditor may have opted to dissent however, such dissent, even if treated as a commercial wisdom of a dissenting financial creditor, cannot be questioned before the Adjudicating Authority. As BoB's decision was not accepted by CoC in its collective decision, what could be and was enforceable was only the collective commercial decision of the CoC.

It remains to be seen whether the Supreme Court will have the opportunity to consider the issue as the law, as it stands currently, effectively wipes out a financial creditor's rights of recovery under personal guarantee agreements.

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