# Between the lines...

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## Key Highlights



### I. Moratorium passed against the Corporate Debtor is not applicable to Personal Guarantor: Supreme Court decides in favour of Creditor while setting aside the judgement of NCLAT

In case of ***State Bank of India v. Mr. V. Ramakrishnan and Others*** (*decided on August 14, 2018*), the Hon'ble Supreme Court resolved the issue relating to applicability of moratorium passed under Section 14 of the Insolvency and Bankruptcy Code, 2016 (**"IBC"**) on the corporate debtor, against the personal guarantor, where the insolvency proceedings have commenced prior to coming into force of Insolvency and Bankruptcy Code (Amendment) Act, 2018 (**"Amendment Act, 2018"**).

**Facts**

State Bank of India (**"Creditor"**) had advanced a loan to M/s. Veesons Energy Systems Private Limited (**"Corporate Debtor"**) for which a personal guarantee was given by one of the directors of the said Corporate Debtor, Mr. V. Ramakrishnan (**"Personal Guarantor"**). Subsequently, the Corporate Debtor defaulted on the repayment of the loan, and consequent thereto, the Creditor issued a notice under Section 13(2) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, (**"SARFAESI Act"**) against the Personal Guarantor for recovering the outstanding dues. As no payment was made, the Creditor issued a 'Possession Notice' under Section 13(4) of the SARFAESI Act and took symbolic possession of the secured assets.

The Corporate Debtor filed an application under Section 10 of the IBC before the National Company Law Tribunal (**"NCLT"**), Chennai to initiate the corporate insolvency resolution process against itself. The NCLT, Chennai passed an order of moratorium and an 'Interim Resolution Professional' was appointed. However, the Creditor continued to proceed against the property of the Personal Guarantor by issuing a 'Sale Notice' under the SARFAESI Act even after the declaration of the moratorium. Aggrieved by the act of the Creditor, the Personal Guarantor filed an application before

the NCLT, Chennai for stay of proceedings under the SARFAESI Act and pleaded that moratorium would apply to the Personal Guarantor as well, as a result of which proceedings against the Personal Guarantor and his property would have to be stayed. The application was allowed and the Creditor was restrained from proceeding against the Personal Guarantor till the period of moratorium was over.

The Creditor filed an appeal in the National Company Law Appellate Tribunal (**"NCLAT"**), which was dismissed on the ground that since the Personal Guarantor can also be proceeded against, and forms part of a resolution plan which is binding on him, he is very much part of the insolvency process against the Corporate Debtor, and therefore, the moratorium imposed should apply to the Personal Guarantor as well. Aggrieved by the decision of the NCLAT, the Creditor filed an appeal to the Supreme Court and following issue came up for determination:

**Issue**

Whether Section 14 of the IBC, which provides for a moratorium for the limited period, on admission of an insolvency petition, would apply to a personal guarantor of a corporate debtor?

**Arguments**

The Creditor argued that the Corporate Debtor and Personal Guarantor are separate entities and a Corporate Debtor undergoing insolvency proceedings under IBC would not mean that a Personal Guarantor is also undergoing the same process. Relying upon Section 128 of the Indian Contract Act, 1872, the Creditor submitted that as the guarantor's liability is distinct and separate from that of the Corporate Debtor, a suit can be maintained against the surety, though the principal debtor has not been sued. The Creditor also relied upon Sections 96 and 101 under Part III of the IBC and submitted that an insolvency resolution process against a personal guarantor can be initiated only under Part III of the IBC and therefore moratorium passed under Section 14 of the IBC cannot possibly attach to a personal guarantor. Section 101 of the IBC does not speak of a 'debtor' but speaks 'in relation to the debt' and is not only wider than Section 14, but would attach only if Part III proceedings were to be instituted against the personal guarantor. The Creditor also submitted that Amendment Ordinance dated June 6, 2018 substituted Section 14(3) of the IBC, which now excludes the applicability of moratorium passed under Section 14, to a surety in a contract of guarantee to a corporate debtor. For this, the Creditor relied upon the Insolvency Law Committee proceedings, which referred to the impugned judgment of the NCLAT in the present matter and led to the aforesaid amendment. Amicus Curie appointed in the present matter also supported the contention of the Creditor.

The Personal Guarantor relied upon Section 60(2) *(insolvency proceedings against the personal guarantors to be filed in the same NCLT as that of corporate debtor)* and Section 31 *(resolution plan for corporate debtor to be binding on guarantors)* of the IBC and argued that the said sections precludes the Creditor from proceeding against the Personal Guarantor under SARFAESI Act or any other Act outside the IBC. He also relied upon a judgment of the Allahabad High Court in ***Sanjeev Shriya v. State Bank of India and Others*** *(decided on September 6, 2017),* which stated that as a proceeding relatable to the corporate debtor is pending adjudication in two forums, it is not permissible to proceed against the personal guarantor. The Personal Guarantor submitted that as per Amendment

Act, 2018, which came into effect on November 23, 2017, Section 2(e) was substituted so as to include in the applicability of the IBC, the personal guarantors to corporate debtors. He also relied upon the statement of objects of the Amendment Act, 2018, which was, inter alia, to extend the provisions of the IBC to personal guarantors of corporate debtors, to further strengthen the corporate insolvency resolution process.

**Observations of the Supreme Court**

The Supreme Court observed that a plain reading of Section 14 of the IBC, which refers to four matters that may be prohibited once the moratorium comes into effect, leads to the conclusion that the moratorium can have no manner of application to personal guarantors of a corporate debtor. Turning down the arguments of the Personal Guarantor, the Supreme Court observed that Section 60(2) of the IBC merely locates the NCLT which has territorial jurisdiction in insolvency proceedings against the corporate debtors.

Further, under Section 60(3) of the IBC, if any bankruptcy proceeding against the individual personal guarantor is initiated before initiating the proceeding against the corporate debtor, such proceeding pending in any court or tribunal will be transferred to the NCLT where the proceeding against the corporate debtor are initiated. Hence, Section 2(e) of the IBC, as amended by the Amendment Act, 2018, when it refers to the applicability of the IBC to a personal guarantor of a corporate debtor, would apply only for the limited purpose as contained in Sections 60(2) and 60(3), as stated herein above.

With regard to Section 31 of the IBC, the Supreme Court observed that this Section only states that once a resolution plan, as approved by the committee of creditors, takes effect, it shall be binding on the corporate debtor as well as the guarantor. This is for the reason that otherwise, under Section 133 of the Indian Contract Act, 1872, any change made to the debt owed by the corporate debtor, without the surety's consent, would relieve the guarantor from payment.

The Supreme Court observed that a separate moratorium is applicable in the case of personal guarantors under Sections 96 and 101 of the IBC. The protection of moratorium under these provisions is far greater than that of Section 14 of the IBC in respect of the debt. Section 14 refers only to debts due by corporate debtors, which are limited liability companies, whereas insofar as firms and individuals are concerned, guarantees are given in respect of individual debts by persons who have unlimited liability to pay them and a moratorium against such persons are available only under Part III of the IBC. The Supreme Court observed that the object of the IBC is not to allow the guarantors to escape from an independent and co-extensiveliability to pay off the entire outstanding debt, which is why Section 14 is not applied to them. It is for this reason that the moratorium mentioned in Section 101 of the IBC would cover such persons, as such moratorium is in relation to the debt and not the debtor.

**Decision of the Supreme Court**

The Supreme Court set aside the impugned judgment passed by the NCLAT and allowed the appeal by holding that the clarificatory amendment to Section 14 of the IBC brought by the Amendment Act, 2018 is retrospective in effect, which provides that a moratorium on the corporate debtor would not apply to the Personal Guarantor.

**VA View**

Subsequent to amendment in Section 14 of the IBC by the Amendment Act, 2018, the position of law with regard to applicability of moratorium passed under Section 14 of the IBC on the corporate debtor, against the personal guarantor, is very clear that such moratorium will not apply to a surety in a contract of guarantee to a corporate debtor. However, as regards the pre-Amendment Act, 2018 insolvency proceedings were concerned, Indian High Courts had conflicting opinions, where the Bombay High Court held that said moratorium would not be applicable to the personal guarantor and the Allahabad High Court opined that the said moratorium is applicable to the personal guarantor.

The Supreme Court in this judgment finally resolved the aforesaid issue by holding that moratorium passed under unamended Section 14 of the IBC will not be applicable to the personal guarantor and the clarificatory amendment to Section 14 of IBC brought by the Amendment Act, 2018 is retrospective in nature. This judgement comes as a welcome decision to the creditors as now they can enforce securities of the personal guarantors even in cases where the corporate insolvency resolution process has commenced against the corporate debtor before coming into force of the Amendment Act, 2018.

## II Framing of issues and allowing applicant to furnish new evidence at the time of setting aside an arbitral award should be avoided by courts

The Supreme Court in ***M/S. Emkay Global Financial Services Limited v. Girdhar Sondhi*** *(decided on August 20, 2018)* held that when an application is made under Section 34 of the Arbitration and Conciliation Act, 1996 (**"Arbitration Act"**) the court is not required to frame issues or take on record any evidence not beyond the record that was before the arbitrator. Taking of additional evidence is permitted only under extraordinary circumstances when relevant to the determination of issue of setting aside the arbitral award.

**Facts**

An arbitration proceeding was initiated against M/S.Emkay Global Financial Services Limited (**"Appellant"**) a registered broker with the National Stock Exchange, by Girdhar Sondhi (**"Respondent"**), its client, on account of disputes regarding certain transactions in securities and shares. The arbitration was conducted by referring to the agreement between the Appellant and the Respondent (**"Agreement"**) which stated that the disputes would be resolved by way of arbitration and the Courts in Mumbai would have exclusive jurisdiction. The arbitrator appointed by the parties conducted arbitration in Delhi. He rejected the claim of the Respondent by an arbitration award dated December 8, 2009.

The Respondent then filed an application under Section 34 of the Arbitration Act for setting aside the arbitral award before the District Court, Karkardooma, Delhi. The District Court referred to the exclusive jurisdiction clause contained in the Agreement and stated that the court did not have jurisdiction to proceed further in the matter and,

therefore, rejected the application. In an appeal filed before the Delhi High Court, it was held that since the District Court judgment decided the disputed question of fact without allowing parties to lead evidence, the matter should be remanded to the District Court. The Delhi High Court further held that it was necessary that the disputed questions of fact as regards existence of territorial jurisdiction of the courts at Delhi be decided by the court below after framing an issue to this effect and permitting the parties thereafter to lead evidence on the same. The matter was appealed before the Supreme Court by the Appellant and the following issues were discussed:

**Issue**

1. Whether the exclusive jurisdiction of courts was with the courts of Mumbai or Delhi?
2. Whether framing of issues and permitting parties to lead evidence is required when an application to set aside an arbitral award is filed with the courts under Section 34 of the Arbitration Act?

**Arguments**

The Appellant relied upon the exclusive jurisdiction clause contained in the Agreement. He also referred to the Supreme Court judgment in the case of ***Indus Mobile Distribution Private Limited v. Datawind Innovations Private Limited and Others, [(2017) 7 SCC 678],*** in which it was held that when there is an exclusive jurisdiction clause in an arbitration agreement stating that the courts at a particular place alone would have jurisdiction in respect of disputes arising under the agreement, it would oust all other courts' jurisdiction in the matter, even in a case where no part of cause of action arises at that place. He also referred to Section 34 of the Arbitration Act and stated that when Section 34(2)(a) of the Arbitration Act speaks of a party making an application, who "furnishes proof" of one of the grounds in the sub-section, such proof should only be by way of affidavit of facts not already contained in the record of proceedings before the Arbitrator. The Appellant also stated that, a mini-trial at this stage is not contemplated, as otherwise, the whole object of speedy resolution of arbitral disputes would be stultified.

The Respondent, on the other hand, supported the judgment of the Delhi High Court and argued that as the seat of arbitration was at Delhi, the courts at Delhi would have jurisdiction, even though there is an exclusive jurisdiction clause vesting such jurisdiction only in the courts at Mumbai.

**Observations of the Supreme Court**

The Supreme Court relied on its own judgement in case of ***Indus Mobile Distribution Private Limited v. Datawind Innovations Private Limited and Others*** *(supra),* and concurring with the Appellant held that it was clear in the Agreement that the courts in Mumbai had exclusive jurisdiction in case any disputes arose between the parties and therefore the application under Section 34 of the Arbitration Act could only be filed before the courts in Mumbai. The arbitration which was conducted at Delhi was only at a convenient venue and Delhi was not the seat of arbitration.

The Supreme Court further examined the decision of the Delhi High Court to remand the matter for a full-dressed hearing on what the Delhi High Court referred to as a 'disputed question of fact' relating to jurisdiction. The Supreme Court cited a plethora of judgements, the most important being its own decision in ***Fiza Developers & Inter-Trade***

***Private Limited v. AMCI (India) Private Limited and Another, [(2009) 17 SCC 796].*** The Supreme Court culled out three important points in aforementioned judgement namely: (i) An application under Section 34 of the Arbitration Act is a summary proceeding; (ii) Framing of issues in such proceedings is not necessary; and(iii) Proceedings under Section 34 of the Arbitration Act require to be dealt with expeditiously. The Supreme Court also referred to the report of Justice B. N. Srikrishna Committee to review the institutionalization of the arbitration mechanism in India under which the hand-on application of Section 34 of the Arbitration Act was analysed. The report stated that as under Section 34 of the Arbitration Act, the party applying for setting aside the arbitral award has to furnish proof to the court, this requirement to furnish proof has led to inconsistent practices in some High Courts, where they have insisted on Section 34 proceedings being conducted in the manner as a regular civil suit. Therefore, an amendment should be made to Section 34 of the Arbitration Act whereby the words "furnishes proof that" should be replaced with the words "establishes on the basis of the arbitral tribunal's record that". The Supreme Court was also informed that the Arbitration and Conciliation (Amendment) Bill of 2018, contains an amendment to this effect.

The Supreme Court commented that speedy resolution of disputes has been the reason for enacting the Arbitration Act, and continues to be the reason for adding amendments to the Arbitration Act to strengthen the aforesaid object. Therefore, if issues are to be framed and oral evidence taken in a summary proceeding under Section 34 of the Arbitration Act, this object will be defeated. Further an application for setting aside an arbitral award will not ordinarily require anything beyond the record that was before the arbitrator. However, if there are matters not contained in such record and are relevant to the determination of issues arising under Section 34 of the Arbitration Act, they may be brought to the notice of the court by way of affidavits filed by both the parties.

**Decision of the Supreme Court**

The Supreme Court set aside the judgement of the Delhi High Court and held that (i) only the courts in Mumbai would have exclusive jurisdiction to entertain an application to set aside the arbitral award in this instance; and (ii) issues need not be framed and new evidence/proof need not be furnished or taken by the court in a summary proceeding under Section 34 of the Arbitration Act.

**VA View**

The Supreme Court settled the controversy pertaining to furnishing of proof to the court when an application is made to set aside an arbitral award. The object and purpose of the Arbitration Act is to ensure speedy resolution of disputes and to minimize the interference of the courts. Allowing the parties aggrieved with the arbitral award to lead new evidence, make depositions, conduct cross-examination, defeats this purpose. Therefore, the Supreme Court rightly held that framing of new issues and furnishing of new evidence, that was not available on record before the arbitrator, would not be allowed under most circumstances. However, if there are matters not contained in such

record, and are relevant to the determination of issues arising under Section 34(2)(a) of the Arbitration Act, they may be brought to the notice of the Court by way of affidavits filed by both parties. Cross-examination of persons swearing to the affidavits should not be allowed unless absolutely necessary, as the truth will emerge on a reading of the affidavits filed by both parties.

## III. Supreme Court interprets an arbitration clause hedged with a conditionality

A three-judge bench of the Hon'ble Supreme Court of India in the case of ***United India Insurance Company Limited and Others v. Hyundai Engineering and Construction Company Limited and Others*** *(decided on August 21, 2018)* considered a conditional arbitration clause in an insurance policy.

**Facts**

Hyundai Engineering and Construction Company Limited and Gamon India Limited (**"JV Partners"**) constituted a joint venture (**"JV"**), to which, a contract was awarded for design, construction and maintenance of a bridge (**"Project"**). In this regard, the JV Partners obtained a Contractor All Risk Insurance Policy (**"Policy"**) covering the Project from the United India Insurance Company Limited and Others (**"Appellants"**). Clause 7 of the Policy read as under:

*"7. If any difference shall arise as to the quantum to be paid under this Policy* ***(liability being otherwise admitted)*** *such difference shall independently of all other questions be referred to the decision of an arbitrator to be appointed in writing by the parties in difference, or if they cannot agree upon a single arbitrator to the decision of two disinterested persons as arbitrators of whom one shall be appointed in writing by each of the parties within two calendar months after having been required so to do in writing by the other party in accordance with the provisions of the Arbitration Act, 1940, as amended from time to time and for the time being in force in case either party shall refuse or fail to appoint arbitrator within two calendar months after receipt of notice in writing requiring an appointment the other party shall be at liberty to appoint sole arbitrator and in case of disagreement between the arbitrators, the difference shall be referred to the decision of an umpire who shall have been appointed by them in writing before entering on the reference and who shall sit with the arbitrators and preside at their meetings.*

***It is clearly agreed and understood that no difference or dispute shall be referable to arbitration as herein before provided, if the Company has disputed or not accepted liability under or in respect of this Policy……"***

An accident occurred during the execution of the Project causing significant loss for which the JV submitted an insurance claim to the Appellants. The surveyor of the Appellants found that the claim was not payable as loss was attributable to improper execution of the Project. Expert Committee appointed by the Ministry of Road Transport and Highways also submitted its report on the incident. The Appellants, after considering both the reports, concluded that the claim was not payable. In the intimation to the JV Partners, the Appellants mentioned, *"……the policy specifically excludes any loss/damage caused by faulty design, defective workmanship/material. Further,*

*the revelations of the expert body and the surveyors indicate wilful acts/negligence in execution of work of such nature resulting in the occurrence."* The request for reconsideration of the decision to decline the claim was also rejected.

The JV invoked clause 7 of the Policy (arbitration clause) and nominated an arbitrator. Eventually, the JV Partners filed a petition before the Madras High Court under Section 11 of the Arbitration and Conciliation Act, 1996 which provides for appointment of arbitrator by the court. The Appellants contended before the Madras High Court that as per the arbitration clause, no dispute was referable to arbitration in case of refusal or dispute in respect of the claim.

The Madras High Court decided in favour of the JV Partners and appointed a former judge of the Madras High Court as arbitrator. The Madras High court ruled that there existed an arbitration agreement between the parties in the form of clause 7 of the Policy. The Madras High Court had relied on the decision of the Supreme Court in the case of ***Duro Felguera, S.A. v. Gangavaram Port Limited, [(2017) 9 SCC 729].*** In this case, the Supreme Court had observed that under the amended law, the power of the Supreme Court or the High Court was limited to only examining the existence of an arbitration agreement and nothing more.

**Issue**

Whether clause 7 of the Policy suggested an unequivocal expression of the intention of arbitration or was hedged with a conditionality?

**Observations of the Supreme Court**

The Supreme Court considered the case of ***Oriental Insurance Company Limited v. Narbheram Power and Steel Private Limited, [(2018) 6 SCC 534],*** in which, a similar arbitration clause was under consideration. In this case, the Supreme Court had observed that, *"……the arbitration clause, restricted as it is by the use of the words 'if any difference arises as to the amount of any loss or damage', cannot take within its sweep a dispute as to the liability of the company when it refuses to pay any damage at all."*

The Supreme Court observed that arbitration clause had to be interpreted strictly and that the arbitration clause in the instant case was conditional. The Supreme Court ruled that there could be no arbitration in cases where the insurance company disputes or does not accept the liability in respect of the Policy. According to the Supreme Court, this was a case of denial of the claim in toto which fell in the excepted category as per clause 7, thereby making the arbitration clause ineffective and incapable of being enforced, if not non-existent and referred matter non-arbitrable.

**Decision of the Supreme Court**

The appeal was allowed and the decision of the Madras High Court was set aside with liberty to the JV Partners to take recourse to a civil suit.

**VA View**

We have, in our previous editions, covered several cases where the Supreme Court has, after the amendment to the Arbitration and Conciliation Act, 1996, restricted the interference of the courts under Section 11 petitions. The Arbitration and Conciliation (Amendment) Act, 2015 added sub-section 6A to Section 11 which states that the courts have to confine to the examination of the existence of an arbitration agreement while dealing with such cases thereby providing for a speedy arbitration, ensuring minimum interference by the courts.

This judgment of the Supreme Court may be looked at as giving power to courts to go into examining the arbitration agreement between the parties. According to the Supreme Court, it can be examined whether the clause is capable of being enforced and whether the matter is arbitrable. How far this ruling will go in making the courts interfere with the arbitration process remains to be seen. The Supreme Court should have kept in mind the spirit of the amendments brought to the law by the Arbitration and Conciliation (Amendment) Act, 2015 Act to ensure minimum interference and speedy arbitrations.



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