

Indic Legal Law Journal

Volume No. 1

Issue No. 1

April - May 2022

Pages: 1 - 4

Author Name: Ruma Mini

ROLE OF CORPORATE GURANTOR IN INSOLVENCY BANKRUPTCY CODE

Ruma Minj, Indian Institute of Legal Studies

A guarantor is a financial term used for an individual who promises to pay the corporate debtors' debt in such circumstances when the corporate debtor defaults obligation. Guarantors pledge their own assets as collateral against the debt. A guarantor is generally over the age of 18 and resides in the country where the payment agreement occurs. Guarantors generally exhibit exemplary credit histories and sufficient income to cover the debt payments and when the corporate debtor defaults then at such situation the guarantor's assets may be seized by the creditor.

A "corporate guarantor" means a corporate person who is the surety in a contract of guarantee to a corporate debtor. A guarantor has a right of subrogation against the principal debtor under section 140 of the Contract Act for the debt amount paid on behalf of the principal debtor. However, no such right can be enjoyed when the payment is made by the guarantor after the CIRP in relation to the debt for which the guarantee is provided is concluded. The same is due to the following reasons. The proceedings under the IBC are not recovery proceedings

This issue is squarely covered by the judgement of the NCLAT in *Lalit Mishra and Ors. v. Sharon Biomedicine Ltdⁱ*, wherein the NCLAT held that the guarantor cannot exercise its right of subrogation under the Contract Act as proceedings under the IBC are not recovery proceedings. The object of the proceedings under the IBC is to revive the company and focus on maximization of value of its assets and not to ensure that credit is available to all stakeholders. Thus, no such recovery can be made by guarantor.

Indic Legal Law Journal

In any case, IBC will prevail over Contract Act, once the resolution plan is approved under section 31 of the IBC, the same is binding on all stakeholders including the guarantor. No further claims can be raised by anyone including the guarantor against the principal debtor after such approval. In contrast to the same, under the Contract Act the guarantor has a right of subrogation and the right to be indemnified against the principal debtor. Both these provisions under the contract law basically provide that the guarantor can file a claim against the principal debtor to recover the proceeds it has paid to the creditor. Therefore, there arises a clear inconsistency between the provisions of the contract act and section 31 of the IBC because the former grants a right to raise a claim against the principal debtor whereas the latter prohibits any such claims. The solution to resolve this inconsistency has been provided under section 238 of the IBC which states that if there is inconsistency between IBC and any other law then IBC will prevail. This view has also been upheld by the Supreme Court in PR Commissioner of Income Tax v. Monnet Ispat and Energy Ltd.ⁱⁱ and Innoventive Industries Ltd. v. ICICI Bank and Ors.ⁱⁱⁱ

Therefore, the IBC will prevail over the Contract Act, thereby denying the guarantor of its rights under the Contract Act.

Role of Corporate Guarantor

Corporate guarantors have a prominent role in business dealings when the need of receiving and creating credit arises. Most of these guarantees are for banks and other similar financial entities. Corporate guarantees are a little tough to enforce due to the structural difference between various corporations. A corporation may have different levels of responsible personnel that may include the board of directors, employees as well as shareholders. There exist a mild difference between corporate and personal guarantors which is, a personal guarantor is an individual who agrees to take on the obligations of a debt for a debtor, whereas a corporate guarantor is a corporation that takes on payment responsibilities.

Understanding the nuances of Corporate Guarantor through various cases:

In Mr. V. Ramakrishnan v. M/s. Vecons Energy Systems Pvt. Ltd. And State Bank of India^{iv}, Vecons Energy Systems Pvt. Ltd. took a debt from State Bank of India and personal guarantor to this loan was Mr. V. Ramakrishnan. After default, the creditor approached the personal guarantor

Indic Legal Law Journal

directly to sell the latter's property and realize the portion of its debt. NCLT prohibited the State Bank of India from doing so when the period of moratorium was going on because this would entail creating a charge on the assets of corporate debtor. The same would amount to encumbering the assets of corporate debtor which is prohibited by Section 14 of IBC.

In the case of Vishnu Kumar Agarwal v. Piramal Enterprises Ltd^v, the NCLAT dealt with the issue regarding initiation of CIRP where it was held that there is no bar on filing two simultaneous applications against the 'Principal Borrower' as well as the 'Corporate Guarantors under Section 7 of the IBC. It must be noticed that this decision of the NCLAT has led to several predicaments particularly due to the dearth of provisions under the IBC which can corroborate the said decision. Most importantly, this bench had held, once for the same set of claims, an application is admitted against one of the corporate debtors that is either principal borrower or corporate guarantor, a second application by the same creditor for the same set of claims and default cannot be admitted against the other corporate debtor that is either the principal borrower or corporate guarantor. Notably, Section 14 of the IBC enumerates that the moratorium shall not be applicable to the guarantor suggesting that the creditor can proceed against the corporate guarantor during the corporate insolvency resolution protection of the principal borrower.

In the case Alpha & Omega Diagnostics (India) Ltd. v. Asset Reconstruction Company of India Ltd. & Ors^{vi}, where the Bombay High Court dealt with the question, whether a creditor under the insolvency regime can sell the assets of the personal guarantor. The court examined the word "it" contained in Section 14 of the IBC, 2016 and said that the benefit of moratorium is not available to the personal guarantors of the corporate debtors. Hence, a personal guarantor's assets can be disposed of to satiate the debt, same was reiterated in the case of Schweitzer Systemtek India Pvt. Ltd. v. Pheonix ARC Pvt. Ltd. & Ors.^{vii}.

The apex court in the case Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta^{viii} had clarified the issue of the law of guarantors, which was followed its previous decision in State Bank of India v. Ramakrishna^{ix} wherein it bestowed upon the creditor a right to invoke contracts of guarantees during insolvency proceedings thereby allowing a creditor the maximum recourse possible. Now, with the decision in Piramal Enterprises being dealt by the Supreme Court under an appeal, it becomes unclear as to what procedure ought to be followed when a creditor

Indic Legal Law Journal

moves against the guarantor for the satisfaction of the outstanding debt after the partial payment of the debt by the resolution plan.

Besides, one of the most significant characteristics of a guarantee contract is the co-extensive liability of the principal debtor and the guarantor in terms of section 128 of the Contract Act. This implies that the liability of a guarantor is immediate and is not deferred until the creditor exhausts its remedies against the principal debtor. However, in view of all these contradictions, it is only reasonable that it be affirmed that there is no bar on commencement of corporate insolvency resolution protection against the principal borrower or the guarantor even if a prior CIRP against any one of them subsists.

Conclusion

From the above, it is clear that the CIRP does not bar the creditor to proceed against the guarantors. The rights of a creditor against a guarantor are independent. The position of law is expected to become more clear as time passes. When a principal debtor takes a loan and a guarantee of repayment is provided by a corporate guarantor, the creditor reserves the right to seek a remedy against the corporate guarantor, in a situation of default of a loan by the debtor. The regulations of the corporate guarantor have provided the creditors with a second option from which the payments in lieu of the debt can be recovered which have not been paid by the debtor himself.

Endnotes

ⁱ Lalit Mishra and Ors. v. Sharon Bio Medicine Ltd., Company Appeal (AT) (Insolvency) No. 164 of 2018 (Date of Judgement: December 19, 2018).

ⁱⁱ PR Commissioner of Income Tax v. Monnet Ispat and Energy Ltd., SLP(C) Nos. 6483/2018 (Date of Order: August 10, 2018).

ⁱⁱⁱ Innoventive Industries Ltd. v. ICICI Bank and Ors., A.I.R. 2017 S.C. 4084.

^{iv} Mr. V. Ramakrishnan v. M/s. Vecons Energy Systems Pvt. Ltd. And State Bank of India, CP/510/IB/CB/2017.

^v Vishnu Kumar Agarwal v. Piramal Enterprises Ltd., 151 SCL 555 (2019).

^{vi} Alpha & Omega Diagnostics (India) Ltd. v. Asset Reconstruction Company of India Ltd. & Ors., Company Appeal (AT) (Insol.) No. 116 of 2017.

^{vii} Schweitzer Systemtek India Pvt. Ltd. v. Pheonix ARC Pvt. Ltd. & Ors., Company Appeal (AT) (Insolvency) No. 129 of 2017.

^{viii} Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta, 2019 SCC 1478.

^{ix} State Bank of India v. Ramakrishna, AIR 1983 Bom 142, 1982 (2) BomCR 556.