

## Personal Guarantee and the NCLT By Kritika Angirish

A contract of guarantee is defined under Section 126 of the Indian Contract Act, 1872, as a contract to perform the promise or discharge the liability of a third person in case of his default. The person who gives the guarantee is called the 'surety'; the person in respect of whose default the guarantee is given is called the 'principal debtor', and the person to whom the guarantee is given is called the 'creditor'. Section 128 of the Indian Contract Act, 1872 provides that the liability of the surety is co-extensive with that of the principal debtor unless provided otherwise by the contract.

To understand the concept, we look at *Central Bank of India v. C.L. Vimla*, (2015) 7 SCC 337, where the Supreme Court, while deciding the question regarding the liability of the guarantor under Section 128 of the Contract Act, 1872, held that, “*The legislature has succinctly stated that the liability of the guarantor is co-extensive with that of the principal debtor unless it is otherwise provided by the contract. This Court has decided on this question, time and again, in line with the intent of the legislature. In Ram Kishun v. State of U.P. [(2012) 11 SCC 511], this Court has held that: (SCC p. 518, para 10)*”

*‘10. ... in view of the provisions of Section 128 of the Contract Act, 1872 (hereinafter called ‘the Contract Act’), the liability of the guarantor/surety is co-extensive with that of the debtor.’*

(emphasis supplied)

*The only exception to the nature of the liability of the guarantor is provided in the section itself, which is only if it stated explicitly to be otherwise in the contract.”*

Further, In *C.L. Vimla (supra)*, the Supreme Court again relying on *Ram Kishun (supra)*, held that, “*this Court has also stated that it is the prerogative of the creditor alone whether he would move against the principal debtor first or the surety to realise the loan amount. This Court observed: (SCC p. 518, para 10)*

*“10. ... Therefore, the creditor has a right to obtain a decree against the surety and the principal debtor. The surety has no right to restrain execution of the decree against him until the creditor has exhausted his remedy against the principal debtor for the reason that it is the business of the surety/guarantor to see whether the principal debtor has paid or not. The surety does not have a right to dictate terms to the creditor as to how he should make the recovery and pursue his remedies against the principal debtor at his instance.”*

*Thus, we are of the view that in the present case the guarantor cannot escape from her liability as a guarantor for the debt taken by the principal debtor. In the loan agreement, which is the contract before us, there is no clause which shows that the liability of the guarantor is not co-extensive with the principal debtor. Therefore, Section 128 of the Contract Act will apply here without any exception.*

Thus, from the above it is clear that, in the event of default of repayment of the loan, all the guarantors are liable to repay the guaranteed loan, as and when the liability of the principal debtor (borrower) arises and is defaulted. This is because the liability of the guarantor is co-extensive with principal debtor (borrower).

In law, we have the following remedies that are available to enforce a personal guarantee, which of these are enlisted below:

- a. An action can be preferred for the *enforcement of security interest* which can be undertaken under Section 13 of the SARFAESI Act, 2002;
- b. A civil action for the *recovery of money* can be preferred under Section 19 of Recovery of Debts and Bankruptcy Act, 1993;
- c. A civil suit for *recovery of money* can be instituted in respect of any loan before an ordinary civil court; and
- d. An Insolvency proceeding against the personal guarantor can also be undertaken under the code.

Therefore, it can be seen that if the guarantor has created a security interest over any property/asset owned, and the Creditor falls within the definition of a Secured

Creditor under Section 2(1)(zd) of the SARFAESI Act, 2002 the steps prescribed under Section 13 of the said Act, for enforcement of security against the guarantors can be taken. However, if the guarantor has not created any security interest over the property but owns property and other assets, the Bank or Financial institution as defined under Section 2(d) and 2(h) respectively of the RDB Act, 1993 can prefer an application for recovery before the Debt Recovery Tribunal under Section 19(1) RDB Act, 1993. However, if the Creditor is not a Secured Creditor or a Bank or Financial Institution as defined under the SARFAESI Act, 2002 and RDB Act, 1993 respectively, in that event, the Creditor may institute a civil suit for recovery before an ordinary civil court of competent jurisdiction. These are fact-based situations that depend on the nature of guarantee executed, and therefore, the remedy has to be well thought of before approaching any appropriate forum, However, we are dealing with a scenario where the an insolvency proceeding is already pending before the appropriate forum. However, having stated the above, we will delve into the discussion where an insolvency proceeding that is already pending against a company or a borrower is pending, and the said company has a personal guarantor.

In view of the same, one cannot conclusively do away with the possibility of the creditor preferring an application before the NCLT for insolvency resolution and liquidation of the personal guarantors or enforcing the claim within DRT. It is also pertinent to note that in an event, where an insolvency proceeding is preferred against the personal guarantor under the Insolvency and Bankruptcy Code, 2016, a moratorium would be declared, and owing to which the creditor would be precluded from pursuing any claims before the DRT. However, when no proceeding is pending against the personal guarantor, a claim can be preferred by the above procedures as enumerated.

Accordingly, in case the Personal Guarantors are unable to pay the Creditors demand under the Personal Guarantors, the Creditors could contemplate preferring an application before the NCLT for insolvency resolution and liquidation of the personal guarantors. However, at this stage, it is pertinent to mention that the proceedings under the IBC are not recovery proceedings but proceedings for either insolvency resolution or liquidation and/or bankruptcy, as the case may be. On the

other hand, a suit instituted in a civil Court or proceedings before the DRT against the guarantors, are proceedings for recovery of money. The two proceedings operate in totally different fields. This distinction was also observed by the Bombay High Court in *Sicom Investments and Finance Ltd. v. Rajesh Kumar Drolia and Ors.*, 2017 SCC OnLine Bom 9725. This distinction is important to understand in order to define the mode of preference of a remedy that is to be preferred as it will play a crucial role as to the outcome.

Provisions relating to the definitions, regulation of insolvency professional and miscellaneous provisions of the IBC have been notified from time to time and made effective. However, provisions relating to the Insolvency and Bankruptcy for individuals and partnership firms have not been made effective as yet. Nevertheless, the Insolvency and Bankruptcy Code (Amendment) Act, 2018 (“**First Amendment**”), which came into force with effect from 23.11.2017, added the new clause (e) to Section 2 of IBC, thereby bringing a personal guarantor of a corporate debtor, within the fold of IBC. The new clause is reproduced below for ease of reference:

**‘Section 2 of the Insolvency and Bankruptcy Code, 2016 (“IBC”) (Application):**

*The provisions of this Code shall apply to—*

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*(e) personal guarantors to corporate debtors;’*

That apart, Sections 60 (1) and 60 (2) of IBC were also amended by the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018, which came into force on 06.06.2018. The section is laid down below:

**‘Section 60 of IBC (Adjudicating Authority for corporate persons):**

*(1) The Adjudicating Authority, in relation to insolvency resolution and liquidation for corporate persons including corporate debtors and personal guarantors thereof shall be the National Company Law Tribunal having territorial jurisdiction over the place where the registered office of the corporate person is located.*

*(2) Without prejudice to sub-section (1) and notwithstanding anything to the contrary contained in this Code, where a corporate insolvency resolution process or liquidation proceeding of a corporate debtor is pending before a National Company Law Tribunal, an application relating to the insolvency resolution or bankruptcy of a personal guarantor of such corporate debtor shall be filed before such National Company Law Tribunal.*

*(3) An insolvency resolution process or bankruptcy proceeding of a personal guarantor of the corporate debtor pending in any court or tribunal shall stand transferred to the Adjudicating Authority dealing with insolvency resolution process or liquidation proceeding of such corporate debtor.*

*(4) The National Company Law Tribunal shall be vested with all the powers of the Debt Recovery Tribunal as contemplated under Part III of this Code for the purpose of sub-section (2).*

*(5) Notwithstanding anything to the contrary contained in any other law for the time being in force, the National Company Law Tribunal shall have jurisdiction to entertain or dispose of— (a) any application or proceeding by or against the corporate debtor or corporate person;*

*(b) any claim made by or against the corporate debtor or corporate person, including claims by or against any of its subsidiaries situated in India; and*

*(c) any question of priorities or any question of law or facts, arising out of or in relation to the insolvency resolution or liquidation proceedings of the corporate debtor or corporate person under this Code.*

*(6) Notwithstanding anything contained in the Limitation Act, 1963 or in any other law for the time being in force, in computing the period of limitation specified for any suit or application by or against a corporate debtor for which an order of moratorium has been made under this Part, the period during which such moratorium is in place shall be excluded.'*

It is pertinent to investigate the interpretation undertaken by courts in order to understand the scope of application of the code to a personal guarantor. In *Schweitzer Systemtek India Pvt. Ltd. v. Phoenix ARC Pvt. Ltd. and Ors.*, (decided on 09.08.2017), the NCLAT held that, as per Section 60(2) of IBC, if Corporate Insolvency Resolution Process, or liquidation proceeding of a corporate debtor is pending before the 'Adjudicating Authority', an application relating to the 'insolvency resolution' or 'bankruptcy' of a personal guarantor is required to be filed before the same Bench of the Adjudicating Authority, meaning thereby, that a separate application for initiation of resolution process against the guarantor is required to be filed before the same Bench of the Adjudicating Authority who is hearing the corporate resolution process or liquidation proceeding against principal corporate debtor. The NCLAT further held that Sub-section (3) of Section 60 of the Code makes it clear that if an insolvency resolution process or bankruptcy proceeding of a personal guarantor of the corporate debtor is pending before any other court of law or Tribunal, such as a "Debt Recovery Tribunal", who is the Adjudicating Authority for the purpose of Part-III-Insolvency Resolution and Bankruptcy for Individuals and Partnership Firms, all such proceedings shall also stand transferred to the Adjudicating Authority, dealing with insolvency resolution process or liquidation proceeding of the Corporate Debtor.

It is pertinent to point out that the scope of the code is limited to the 'insolvency resolution' or 'bankruptcy' of a personal guarantor.

A similar view was also expressed by the Bombay High Court in *Sicom Investments (supra)*, while deciding the cause of action in two separate Deeds of Guarantee. The High Court in that case held that:

*“57. What Section 60 (1) contemplates is that the Adjudicating Authority, in relation to insolvency resolution and the liquidation for corporate persons including corporate debtors and personal guarantors thereof shall be the NCLT having territorial jurisdiction over the place where the registered office of the corporate person is located. What sub-section (1) simply means is that when a personal guarantor [as defined in section 5(22)] is in insolvency/bankruptcy, then*

*in relation to his insolvency resolution and bankruptcy, the Adjudicating Authority would be the NCLT having territorial jurisdiction over the place where the registered office of the corporate person is located. This provision has been enacted simply for the reason that otherwise the Adjudicating Authority for the personal guarantor (being an individual), would be the DRT under Section 79 (1) which falls in Part III of the IBC, 2016.*

*Section 60 (2) stipulates that without prejudice to sub-section (1) and notwithstanding anything to the contrary contained in the Code, where a corporate insolvency resolution process or liquidation proceedings of a corporate debtor are pending before the NCLT, then an application relating to the insolvency resolution or bankruptcy of a personal guarantor of such corporate debtor shall be filed before such NCLT. In other words, when a corporate debtor is either in liquidation or in the insolvency resolution process, then notwithstanding anything contained in the Code the insolvency resolution or bankruptcy of its personal guarantor shall be filed before the very same NCLT that is handling the proceedings with reference to the corporate debtor. What is important to also note is that for the purposes of sub-section 2 of Section 60, the NCLT shall be vested with all the powers of the Debts Recovery Tribunal as contemplated under Part III of the Code. This is clear from a plain reading of section 60(4). As I see it, Section 60 carves out an exception with reference to the Adjudicating Authority when it comes to insolvency resolution or bankruptcy of a personal guarantor of a corporate debtor. This, to my mind, is perfectly logical in view of the fact that where the corporate debtor itself is undergoing the insolvency resolution process or liquidation, then, it should be the same Adjudicating Authority (namely the NCLT) who would also undertake the insolvency resolution process and/or bankruptcy of a personal guarantor so that there would not be multiplicity of proceedings and avoid conflicting decisions of two different authorities (namely the NCLT and the DRT).”*

[Emphasis Supplied]

Therefore, it is stated that there is the view of the insolvency of the personal guarantor and not the recovery has been persistently upheld in law by different

Courts. Furthermore, the applicability of the IBC in relation to bankruptcy of a Personal Guarantor was dealt with by the Supreme Court in *State Bank of India v. Ramakrishnan and Ors.*, Civil Appeal No. 3595 of 2018 (decided on 14.08.2018) and while dealing with the debate pertaining to the application of moratorium under Section 14 of IBC, the Supreme Court followed the reasoning discussed above. The Supreme Court observed that Section 14 of IBC (which deals with moratorium period) did not make any reference to personal guarantors and it was only the corporate debtor, which was referred to therein. In such a scenario, a plain reading of Section 14 would lead to the conclusion that the period of moratorium would have no application to the personal guarantors of a corporate debtor. This leads to an end to the parallel proceeding that can be instituted at other courts/tribunals for the recovery of the amount of the guarantee. The Apex Court also observed that Section 60(1) of the Code, which provided that the adjudicating authority in relation to the insolvency resolution and liquidation of both corporate debtors and personal guarantors shall be the NCLT; and was important that the application was filed after locating the NCLT which would have the territorial jurisdiction in proceedings against corporate debtors.

The Court also noticed the reference to ‘personal guarantors’ in sub-sections (2) and (3) of Section 60 and went further on to clarify the scheme of these provisions. It observed that the moment there was a proceeding pending against the corporate debtor under the Code, any bankruptcy or insolvency resolution proceeding against the individual personal guarantor would have to be transferred or filed before the NCLT, as the case may be. However, the Court also clarified that until Part III of the Code is brought into force, the NCLT shall decide the proceedings pertaining to personal guarantors only in accordance with the Presidency-Towns Insolvency Act, 1909 or the Provincial Insolvency Act, 1920 as the case may be. The Supreme Court further observed that Section 2(e), which was brought into force on 23.11.2017, would, when it refers to the application of the Code to a personal guarantor of a corporate debtor, apply only for the limited purpose contained in Section 60(2) and (3), as stated hereinabove.

It is therefore concluded that, if the sureties under the Personal Guarantee do not pay the guarantee amounts after the same are invoked, the creditor may prefer an application for insolvency resolution or bankruptcy of the guarantors before the NCLT, where the corporate debtor, is undergoing the insolvency resolution process. However, if there is no insolvency of the creditor pending, then it is the normal route of recovery that may be preferred. However, it is also important to understand that, the personal guarantor can also be proceeding into a bankruptcy, if they have acted as guarantors for any other company. If the said scenario is true, then there will be a moratorium against the guarantor, however, the said provisions, are yet to be notified.

Before concluding, it is also essential to state that in a recent decision passed by NCLT Chennai Bench in CP/713/IB/CB/2018, CP/936/IB/CB/2018, CP/1031/IB/CB/2018, and CP/1032/IB/CB/2018, the said NCLT while reading the decision of the Supreme Court in *State Bank of India v. V. Ramakrishnan and Ors (supra)*, rejected application filed against the personal guarantors under Section 60(2) of the Code for initiation of their insolvency resolution process. Whilst no appeal has been pending against the said decision, taking into account the thought of decision by the courts, it can be concluded that the decision by the said NCLT is very well an appealable case.

- ***Thankyou***

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