# No Guarantee For Lenders Under IBC

*The credence of guarantees given to lenders ought to be protected under all circumstances in order to ensure that lenders are not left high and dry with huge piles of NPAs*

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Much like various other aspects of the Insolvency and Bankruptcy Code, 2016 (IBC), the issue of moratorium granted to personal guarantors of a corporate debtor undergoing the process of Insolvency Resolution has also been evolving since the IBC came into effect.

Both the Sick Industrial Companies Act, 1985 (SICA) and the IBC contain provisions relating to the continuity of proceedings/prohibiting suits and proceedings against corporate debtors, with the former making a slight and restrictive inclusion of suits of guarantee within this prohibition (s. 22 SICA) and the latter requiring the transfer of all IRP (Insolvency Resolution Process) and Bankruptcy proceedings before courts and tribunals to the NCLT, thereby indicating an implied prohibition (s. 60 IBC). It is noteworthy how courts and tribunals had an unprecedented hesitation in subjecting this limited benefit to the generality of prohibiting of suits and proceedings against corporate

debtors including a recent NCLAT decision changing the course of the interpretation. Is such a track change a result of the change in regime (from SICA to IBC) and does it reflect the spirit behind the IBC?

Under the SICA regime, in the case of *M/s Patheja Bros. Forgings & Ors vs. ICICI Ltd & Ors (2000) 6 SCC 54*, it was held that no suit for the enforcement of a guarantee in respect of any loan or advance granted to the concerned industrial company will lie or can be proceeded with or without the consent of the Board or the Appellate Authority. Subsequently, contrary to the findings in *Patheja Bros.*, in the case of *Kailash Nath Agarwal vs. PICUP reported in AIR 2003 SC 1886*, it was held that the object for enacting the SICA was to facilitate the rehabilitation or winding up of sick industrial companies and not to protect any other person or body. If creditors enforce a guarantee in respect of a loan granted to an industrial company, the provisions of SICA would not be rendered nugatory as a guarantor would step into the shoes of a creditor vis-à-vis the company to the extent of the liability met. Thereafter, again restoring the status as prevailed in Patheja's case, the Hon'ble Supreme Court in *Paramjit Singh Patheja vs. ICDS, reported in AIR 2007 SC 168*, held that a provision must be construed in a manner which would give effect to its purpose and to cure the mischief in the light of which it was enacted. In view of the same, it was observed that the object of Section 22, in protecting guarantors from legal proceedings pending a reference to BIFR of the principal debtor, was to ensure that a scheme for rehabilitation would not be defeated by isolated proceedings adopted against the guarantors of a sick company. Due to this anomaly created by the conflicting views, the issue was referred to a larger bench in the case of *Zenith Steel Tubes & Industries Ltd. and Anr v. SICOM Limited*, which recorded the divergent views of courts on this issue; however, the matter ultimately was settled out of court and the complex issues remain unanswered.

In order to appreciate this question of the liability of personal guarantors in circumstances of insolvency, wherein the inability to repay a debt by a corporate debtor is involuntary, it would be necessary to first extract the relevant provisions, i.e., Sections

128 and 134 of the Contract Act. Under Section 128 of the Contract Act, the liability of the surety is co-extensive with that of the principal debtor, unless it is otherwise provided by the contract. Similarly, under Section 134 of the Contract Act, the surety is discharged by any contract between the creditor and the principal debtor, by which the principal debtor is released, or by any act or omission of the creditor, the legal consequence of which is the discharge of the principal debtor. In *Bank of Bihar Ltd. v. Damodar Prasad and another, [1969] 1 SCR 620*, the Supreme Court, while outlining the duty of a guarantor under the provisions of the Contract Act, explained that a decree made against a guarantor jointly with the principal borrower can be independently executed or enforced and that it is the duty of the surety to pay the decretal amount. On such payment, the guarantor will be subrogated to the rights of the creditor under Section 140 of the Indian Contract Act, who may then recover the amount from the principal borrower. The very object of the guarantee is defeated if the creditor is asked to postpone his remedies against the surety. The principle discussed in the above decision was reiterated by a three-judge bench of the Supreme Court in *State Bank of India vs. Indexport Registered & Ors. AIR 1992 SC 1740*, wherein it was held that the surety has no right to restrain execution against him until the creditor has exhausted remedies against the principal debtor.

The reasoning applied in the NCLAT case of State Bank of India v. V. Ramakrishnan (vide its judgment dated 28.02.2018 in Company Appeal (AT) (Insolvency) No. 213 of 2017) in laying down that the "corporate debtor" for the purposes of Section 14's prohibition against suits and proceedings during the moratorium period includes "personal guarantor" is in direct contradiction of its own orders in the earlier cases decided by it in the matter of *Scheweitzer Systemtek India Private Limited in Company Appeal (AT) (Insolvency) No. 129 of 2017* and *Alpha and Omega Diagnostics (India) Limited in Company Appeal (AT) (Insol.) No. 116 of 2017. In the Scheweitzer case*, NCLT, Mumbai, held that the 'Moratorium' has no application on the properties beyond the ownership of a corporate debtor. The basis for arriving at such a conclusion is the language used in Section 14 (1) (c) of the Code which refers "its assets" and denotes the property owned by "corporate debtor". Therefore, while interpreting the provision contained in Section 14 (1) (c), the NCLT pointed out that in this Section, the language is so simple that there is no scope even to supply 'casus omissus'. Further, in the NCLT's opinion, the doctrine of 'Noscitur a Sociis' is somewhat applicable that the associated words take their meaning from one another so that common sense meaning coupled together in their cognate sense be interpreted. As a result, "its" denotes the property owned by a corporate debtor.

The NCLAT, however, in *Alpha & Omega Diagnostics* was of the view that in case a creditor intends to initiate proceedings against a personal guarantor, a separate bankruptcy proceedings can be filed against the personal guarantor before the same adjudicating authority hearing the resolution process of the corporate debtor. The reasoning given by the NCLAT was that the Resolution Plan, if approved by the Committee of Creditors as per Section 30 (4) of the IBC and subsequently approved by the Adjudicating Authority, shall not only bind the corporate debtor, but also its employees, members, creditors, guarantors, and other stakeholders involved in the Resolution Plan, which shall include the 'personal guarantor'. It was on this reasoning that the NCLAT arrived at a view that since the resolution plan of a corporate debtor binds a personal guarantor, the moratorium would also apply to such personal guarantor and not be restricted to the properties of the corporate debtor only.

A similar view was adopted by the Hon'ble Allahabad High Court in the case of *Sanjeev Shriya & Ors vs. State Bank of India, 2017(9) ADJ 723*, wherein it was held that once a proceeding has already been commenced under IBC, 2016 and Moratorium under Section 14 of IBC, 2016 has already been issued, and even in the said proceeding, the parties have put their appearance before insolvency professionals, the impugned proceeding against the guarantors of a principal debtor is per se bad.

It was only subsequently in the case of SBI vs. D.S. Rajendra Kumar, in Company Appeal (AT) (Insolvency) No. 87 of 2018 that NCLAT made it clear that order of 'Moratorium' will be applicable only to the proceedings against the 'Corporate Debtor' and the 'Personal Guarantor', if pending before any court of law/Tribunal or authority but the order of 'Moratorium' will not be applicable for filing application for triggering 'Corporate Insolvency Resolution Process' under Sections 7 or 9 or 10 of the IBC against the 'Guarantor' or the 'Personal Guarantor' under Section 60(2). Thus the issue certainly requires comprehensive re-examination in the context of the inconsistent views taken by the NCLAT and the Allahabad High Court, which failed to appreciate the concerns of the lenders in seeking the guarantees, and in case they had to await the outcome of the entire resolution process before initiating any action against the guarantors or in the alternate, accept the payments as per the resolution plan, while the guarantees remain a paper assurance in the hands of the lenders. This dichotomy, however, was never intended under the Contract Act, and thus, there cannot be a two-way interpretation on the issue. The credence of the guarantees given to lenders ought to be protected under all circumstances in order to bring more transparency and enforceability of obligations in financial transactions in order to ensure that lenders are not left high and dry with huge piles of NPAs.

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***Dr. Manoj Kumar (Founder and Managing Partner) expressed his views on the topic "E-Commerce and the Digital Economy in India: Challenges & Opportunities"***


***Ms. Shweta Bharti (Senior Partner) moderated the panel of experts which was tasked with deciphering and sharing views on the topic: "ADR for the Future: Digitizing Justice".***