

LIABILITY OF A PERSONAL GUARANTORS (PGs) TO CORPORATE DEBTORS (CDs) UNDER IBC*

Brief Facts

The Central Government, vide notification dated 15th November, 2019, brought into force provisions relating to the Personal Guarantors (PGs) to Corporate Debtors (CDs) with effect from 1st December, 2019. The impugned notification issued in the Gazette of India Extraordinary, by the Ministry of Corporate Affairs, reads as follows:

In exercise of the powers conferred by sub-section (3) of section I of the Insolvency and Bankruptcy Code, 2016 (31 of 2016), the Central Government hereby appoints the 1st day of December, 2019 as the date on which the following provisions of the said Code only in so far as they relate to personal guarantors to corporate debtors shall come into force:

Number	Section	Particular of Section
(1)	Clause (e) of section 2;	Application of the Code to Personal Guarantors to Corporate Debtors
(2)	Section 78 (except with regard to fresh start process) and section 79;	Application & Definitions pertaining to Insolvency Resolution and Bankruptcy for Individuals and Partnership Firms (Chapter I-Preliminary)
(3)	Sections 94 to 187 (both inclusive);	Chapter III - Insolvency Resolution Process pertaining to Insolvency Resolution and Bankruptcy for Individuals and Partnership Firms
(4)	Clause (g) to clause (i) of sub-section (2) of section 239;	Power of Central Government to make Rule pertaining to Section 239(2)(g) to 239(2)(i)
(5)	Clause (m) to clause (zc) of sub-section (2) of section 239;	Power of Central Government to make Rule pertaining to Section 239(2)(m) to 239(2)(zc)
(6)	Clause (zn) to clause (zs) of sub-section (2) of section 240; and	Power of Board to make Regulations pertaining 240(2)(zn) to 240(2)(zs)
(7)	Section 249.	Amendments of Act 51 of 1993- The Recovery of Debts due to Banks and Financial Institutions Act, 1993 shall be amended in the manner specified in the Fifth Schedule.

* Chittaranjan Pal, Assistant Director, The ICSI

Views expressed in the Article are the sole expression of the Author and may not express the views of the Institute.

According to the above Notification, the personal guarantors to corporate debtors were brought within the scope of the insolvency proceedings under the Insolvency and Bankruptcy Code, 2016.

Several petitions were filed in different High Courts challenging the said notification and related Rules and Regulations. The common question in the instant matter relates to the *vires* and validity of the Notification and the Hon'ble Supreme Court directed transfer of petitions from High Courts to itself.

Personal Guarantors Separately from other Individuals

The Hon'ble Supreme Court of India in the matter of *Lalit Kumar Jain vs. Union of India & Ors. [Transferred Case (Civil) No. 245/2020 and other writ petitions] Judgment dated 21st May, 2021 inter-alia* observed that Parliamentary intent was to treat personal guarantors differently from other categories of individuals. The intimate connection between such individuals and corporate entities to whom they stood guarantee, as well as the possibility of two separate processes being carried on in different forums, with its attendant uncertain outcomes, led to carving out personal guarantors as a separate species of individuals, for whom the Adjudicating authority was common with the corporate debtor to whom they had stood guarantee. The fact that the process of insolvency in Part III is to be applied to individuals, whereas the process in relation to corporate debtors, set out in Part II is to be applied to such corporate persons, does not lead to incongruity.

On the other hand, there appear to be sound reasons why the forum for adjudicating insolvency processes – the provisions of which are disparate- is to be common, i.e. through the NCLT. As was emphasized during the hearing, the NCLT would be able to consider the whole picture, as it were, about the nature of the assets available, either during the corporate debtor's insolvency process, or even later; this would facilitate the Committee of the Creditor (CoC) in framing realistic plans, keeping in mind the prospect of realizing some part of the creditors' dues from personal guarantors.

Validity of the Notification

The impugned notification is not an instance of legislative exercise, or amounting to impermissible and selective application of provisions of the Code. There is no compulsion in the Code that it should, at the same time, be made applicable to all individuals, (including personal guarantors) or not at all.

There is sufficient indication in the Code- by Section 2(e), Section 5(22), Section 60 and Section 179 indicating that personal guarantors, though forming part of the larger grouping of individuals, were to be, in view of their intrinsic connection with corporate debtors, dealt with differently, through the same adjudicatory process and by the same forum (though not insolvency provisions) as such corporate debtors.

The notifications under Section 1(3), (issued before the impugned notification was issued) disclose that the Code was brought into force in stages, regard being had to the categories of persons to whom its provisions were to be applied.

The impugned notification, similarly inter alia makes the provisions of the Code applicable in respect of personal guarantors to corporate debtors, as another such category of persons to whom the Code has been extended.

It is held that the impugned notification was issued within the power granted by Parliament, and in valid exercise of it. The exercise of power in issuing the impugned notification under Section 1(3) is therefore, **not ultra vires; the notification is valid.**

Approved Plan is Binding on the Guarantor

The Hon'ble Supreme Court in *Lalit Kumar Jain Vs. Union of India & Ors. [Transferred Case (Civil) No. 245/2020 and other writ petitions]* observed that the rationale for allowing directors to participate in meetings of the CoC is that the directors' liability as personal guarantors persists against the creditors and an approved resolution plan can only lead to a revision of amount or exposure for the entire amount. Any recourse under Section 133 of the Contract Act to discharge the liability of the surety on account of variance in terms of the contract, without her or his consent, stands negated by this court, in V. Ramakrishnan where it was observed that the language of Section 31 makes it clear that the approved plan is binding on the guarantor, to avoid any attempt to escape liability under the provisions of the Contract Act. It was observed that:

"25. Section 31(1), in fact, makes it clear that the guarantor cannot escape payment as the resolution plan, which has been approved, may well include provisions as to payments to be made by such guarantor...."

And further that:

"26.1 Section 14 refers only to debts due by corporate debtors, who are limited liability companies, and it is clear that in the vast majority of cases, personal guarantees are given by Directors who are in management of the companies. The object of the Code is not to allow such guarantors to escape from an independent and coextensive liability to pay off the entire outstanding debt, which is why Section 14 is not applied to them. However, 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 such guarantors may be complete strangers to the debtor — often it could be a personal friend. It is for this reason that the moratorium mentioned in Section 101 would cover such persons, as such moratorium is in relation to the debt and not the debtor."

Liability of a PG to CD in case Resolution Plan is Approved

The sanction of a resolution plan and finality imparted to it by Section 31 does not per se operate as a discharge of the guarantor's liability. As to the nature and extent of the liability, much would depend on the terms of the guarantee itself. However, this court has indicated, time and again, that an involuntary act of the principal debtor leading to loss of security, would not absolve a guarantor of its liability. In *Maharashtra State Electricity Board Bombay v. Official Liquidator* the liability of the guarantor (in a case where liability of the principal debtor was discharged under the insolvency law or the company law), was considered. It was held that in view of the unequivocal guarantee, such liability of the guarantor continues and the creditor can realize the same from the guarantor in view of the language of Section 128 of the Contract Act as there is no discharge under Section 134 of that Act. This court observed as follows:

"7. Under the bank guarantee in question the Bank has undertaken to pay the Electricity Board any sum up to Rs 50,000 and in order to realise it all that the Electricity Board has to

do is to make a demand. Within forty-eight hours of such demand the Bank has to pay the amount to the Electricity Board which is not under any obligation to prove any default on the part of the Company in liquidation before the amount demanded is paid. The Bank cannot raise the plea that it is liable only to the extent of any loss that may have been sustained by the Electricity Board owing to any default on the part of the supplier of goods i.e. the Company in liquidation. The liability is absolute and unconditional. The fact that the Company in liquidation i.e. the principal debtor has gone into liquidation also would not have any effect on the liability of the Bank i.e. the guarantor. Under Section 128 of the Indian Contract Act, the liability of the surety is coextensive with that of the principal debtor unless it is otherwise provided by the contract. A surety is no doubt discharged under Section 134 of the Indian Contract Act 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. But a discharge which the principal debtor may secure by operation of law in bankruptcy (or in liquidation proceedings in the case of a company) does not absolve the surety of his liability (see Jagannath Ganeshram Agarwala v. Shivnarayan Bhagirath [AIR 1940 Bom 247; see also In re Fitzgeorge Ex parte Robson [(1905) 1 KB 462]].”

Conclusion

In view of the above discussion, it is held that approval of a **resolution plan does not ipso facto discharge a personal guarantor (of a corporate debtor)** of her or his liabilities **under the contract of guarantee**. As held by this court, the release or discharge of a principal borrower from the debt owed by it to its creditor, by an involuntary process, i.e. by operation of law, or due to liquidation or insolvency proceeding, does not absolve the surety/guarantor of his or her liability, which arises out of an independent contract.

While dismissing the petitions, the Supreme Court held:

- i. the notification dated 15th November, 2019 is legal and valid; and
- ii. approval of a resolution plan relating to a Corporate Debtor not operate as a discharge of the liabilities of Personal Guarantors the Corporate Debtor.

Source:

1. <https://www.ibbi.gov.in/uploads/legalframework/982f0ad78155daecf90a1dcd70d0db3f.pdf>
2. <https://www.ibbi.gov.in/uploads/order/8cff46ae7049df781ad8ce6c4694dcfd.pdf>
3. Judgment dated 21st May, 2021 of the Hon'ble Supreme Court of India in the matter of Lalit Kumar Jain Vs. Union of India & Ors. [Transferred Case (Civil) No. 245/2020 and other writ petitions]
