

---

**INTERNATIONAL JOURNAL OF ADVANCED LEGAL RESEARCH**

---

**PROMINENT POSITION OF PERSONAL GUARANTORS**

- Aakanksha Sahebrao Bhukan & Addvit Piyush Shrivastava<sup>1</sup>

**Abstract**

The Insolvency and Bankruptcy Code has paved the way as a resort to the earlier regimes that controlled the issues of debt restructuring and recovery. With the recent pioneering amendments, the Code now has a silvery sheen. In the financial transaction between the financial creditor and corporate debtor, the personal guarantor and their surety play a significant part, acting as an additional safety for the financial creditors. Banks and financial institutions are under considerable pressure to provide loans to corporate debtors and, among them, to SMEs in particular. Due to the increased number of bankruptcy cases after the COVID-19 pandemic, numerous reports indicate that lenders to corporate debtors can now only recover approximately 30% of the owed amount, necessitating their acceptance of a 70% haircut.

Consequently, there has been a significant surge in insolvency cases against personal guarantors who provided guarantees to lenders on behalf of the corporate debtors. These guarantors find themselves entangled in legal battles as the validity of their surety is tested in courts and tribunals, compelling them to fulfil the corporate entities' obligations. The Government of India, vide notification dated November 15, 2019<sup>i</sup>, shifted the radar of corporate liability onto the personal guarantors in case of default in repayment by the corporate debtor. Simplistically, the notification is centred on Part III of the Insolvency and Bankruptcy Code, 2016, which comprehensively describes the execution of various rules on Personal Guarantors.

**A Paradigm Shift**

Personal guarantors were not directly tied to the insolvency proceedings before the amendment. The notification was incipiently challenged under Article 32 of the Indian

---

<sup>1</sup> Students of Dr. D. Y. Patil College of Law, Mumbai

For general queries or to submit your research for publication, kindly email us at [editorial@ijalr.in](mailto:editorial@ijalr.in)

<https://www.ijalr.in/>

Constitution in *Lalit Kumar Jain v. UOI, 2021*<sup>iii</sup>. While deciding whether a corporate creditor can proceed against the corporate debtor and personal guarantor simultaneously, the apex court answered affirmatively with an admonition that the creditors cannot recover more than the total sum claimed. Section 5(22) of the Insolvency and Bankruptcy Code, 2016<sup>iii</sup> defines a Personal Guarantor as “an individual who is a surety in a contract of guarantee to the corporate debtor”. Since the definition of a Personal Guarantor under IBC explicitly mentions the term ‘surety in a contract of guarantee’, provisions of the parental statute, the Indian Contract Act, 1872, come to the fore. A contract of guarantee involves the undertaking by the surety to be liable for the default of another. Deposits are usually taken to provide a second pocket to pay if the first should be empty<sup>iv</sup>. Pertinently, Section 128 of the Indian Contract Act, 1872<sup>v</sup> reads that the surety's liability is co-extensive with that of the principal-debtor, wherefore the term ‘co-extensive’ indicates that he is liable for the whole of the amount for which the principal debtor is exposed, and he is responsible for no more. In *Bank of Bihar v. Damodar Prasad, 1969*<sup>vi</sup>, the top Court was of the rationale that “the solvency of the principal is not a sufficient ground for restraining the execution of a decree against the surety. It is the duty of the surety to pay the decretal amount.”

Furthermore, regarding IBC, discharge of surety under Section 134 of the Indian Contract Act, 1872<sup>vii</sup> has no application in insolvency cases. The section briefly says that “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”. Express and implied release are the two ingredients of the respective section, wherein the former involves an express contract between the creditor and principal debtor that results in discharge. At the same time, the latter consists of any act or omission of the creditor leading to discharge or release. Timely, in the context of the Insolvency and Bankruptcy Code, a question arose before the Supreme Court in the case of *Maharashtra State Electricity Board v. Official Liquidator, 1982*<sup>viii</sup>, through which the applicability of S. 134 coupled with the insolvency proceedings was observed. The Hon'ble Court opined that 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 or guarantor of his liability, which arises out of an independent contract. A resolution plan does not ipso facto discharge a personal guarantor (of a corporate debtor) of his liabilities under the guarantee contract.

Conclusively, this makes the position of the surety vulnerable, and thus, the rights of the personal guarantors come into the picture.

### **Rights of Personal Guarantors**

With all that has been broached, it gives the impression that the personal guarantors have no way to escape the liability. However, certain agreements specifically state to what extent they may provide the guarantee, thereby limiting their liability to a specified amount or a defined portion of the outstanding debt in the event of a corporate debtor's default. In the case of *Nitin Chandrakant Naik v. Sanidhya Industries LLP and Ors., 2021*,<sup>ix</sup> it was averred that the personal properties of the personal guarantors could not be transferred in the CIRP of the corporate debtors. These clauses offer personal guarantors a degree of protection and ensure that their obligations under the guarantee are not open-ended. The Personal Guarantors' Insolvency Resolution Process (PGIRP) also involves an interim moratorium whereby the 'moratorium' is defined as the "stopping of an activity for an agreed amount of time". The importance of the temporary suspension can be read positively because it may allow ample time for the personal guarantor to meditate on settling his debts with creditors or setting up a settlement plan. No legal action can be announced or pursued against the personal guarantee during the moratorium period, and creditors are barred from going after any security interest created by the personal guarantor.

The provisions of section 14(1) of the Code are extensive and appear to be a complete bar against the institution or continuation of suits or any legal proceedings against a corporate debtor on the declaration of moratorium by the adjudicating authority. Sub-section (1) of Section 14 is reproduced here:

#### **Section 14(1):**

- (a) the institution of suits or continuation of pending claims or proceedings against the corporate debtor, including execution of any judgment, decree or order in any court of law, tribunal, arbitration panel or other authority;
- (b) transferring, encumbering, alienating, or disposing of by the corporate debtor any of its assets or any legal right or beneficial interest therein;
- (c) any action to foreclose, recover or enforce any security interest created by the corporate debtor in respect of its property, including any activity under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;

For general queries or to submit your research for publication, kindly email us at [editorial@ijalr.in](mailto:editorial@ijalr.in)

<https://www.ijalr.in/>

(d) the recovery of any property by an owner or lessor where such property is occupied by or in the possession of the corporate debtor.

On September 6, 2017, the Allahabad High Court observed apropos and significant findings. In the case involving *Sanjeev Shriya v. State Bank of India & Others, 2017<sup>x</sup>*, Mr Sanjeev Shriya, acting as a director of L.M.L Limited, found himself entrapped in pending debt recovery proceedings before the Debt Recovery Tribunal (DRT). Simultaneously, L.M.L Limited faced insolvency resolution proceedings before the NCLT in Allahabad. This insolvency situation triggered the application of a moratorium under Section 14 of the IBC. After extending a personal guarantee to the State Bank of India (SBI) for a loan to L.M.L Limited, the petitioner became ensnared in legal action initiated by SBI due to the company's default on its obligations. The petitioner contested the DRT proceedings, citing the moratorium declared by the NCLT under Section 14 of the IBC. The Hon'ble High Court ruled that the liability of the Company and Petitioners are co-extensive, and two separate proceedings cannot be filed concurrently before the Debt Recovery Tribunal and the National Company Law Tribunal for the exact cause of action. Additionally, it was held that the liability had not been crystallised either against the principal debtor or the guarantors and thus, the proceeding before the Hon'ble Debt Recovery Tribunal could not continue until the Corporate Insolvency Resolution Process (CIRP) was completed or until the Hon'ble National Company Law Tribunal approved the resolution plan under Section 31<sup>xi</sup> or passed an order for corporate debtor liquidation under Section 33<sup>xii</sup>.

### **SBI sues Anil Ambani**

While personal guarantors can provide a fair playing field for bankers and borrowers at a negotiation table, a recent lawsuit filed by SBI against Anil Ambani has sparked new debates. SBI had given Ambani loan facilities of Rs. 1200 crores in August 2016 for two of his companies, namely, Reliance Communications (RCom) and Reliance Infratel Limited (RITL), in exchange for an Agreement of Personal Guarantee, which implied a personal guarantee for the repayment of his company's loans. Eventually, Non-Performing Assets (NPAs) were assigned to the loan accounts. In early 2020, SBI, Reliance's creditor, filed an insolvency application against Mr Ambani under Section 95<sup>xiii</sup> of the Insolvency and Bankruptcy Code. To recover the debts, the National Company Law Tribunal (NCLT) in Mumbai authorised the appointment of an interim Resolution Professional (RP). The NCLT

For general queries or to submit your research for publication, kindly email us at [editorial@ijalr.in](mailto:editorial@ijalr.in)

<https://www.ijalr.in/>

further stated that action could be taken against Mr Ambani, the personal guarantor, even before a Resolution Plan was agreed upon. This entailed putting Mr Ambani's assets on hold for the time being. Mr. Ambani argued that these provisions are arbitrary, unconstitutional, and violate fundamental rights guaranteed under the Constitution of India. Section 96<sup>xiv</sup> imposes an interim moratorium on all debts against the personal guarantor as soon as the creditor files an insolvency application under Section 95 without providing them a chance to be heard. A copy of the Resolution Professional's report is not provided to the debtor or personal guarantor under Section 99<sup>xv</sup> of the Code, depriving them of the right to know why an insolvency application has been accepted or denied. The challenge further claims that the Code empowers the resolution professional to act as a judge in his case and is not accountable to anybody when placing the debtor's or personal guarantor's assets under a moratorium. The matter is still pending before the Hon'ble Supreme Court.

The case is one of the first high-profile since personal bankruptcy regulations were established recently. Bankers and investors closely follow the case as the verdict would determine lenders' ability to take action against owners who guaranteed loans to companies that later went bankrupt.

### Conclusion

So far, the National Company Law Tribunal has admitted 5,893 cases for bankruptcy resolution. As it stands, the IBC is steadily growing. In all likelihood, the amendment will make the long-elusive recovery of defaulted loans a reality, as defaulters have come to understand they will forfeit their crown jewels, however, faded they may be, if they persist in acting irresponsibly.

---

<sup>i</sup>[https://www.mca.gov.in/Ministry/pdf/Notification\\_18112019.pdf](https://www.mca.gov.in/Ministry/pdf/Notification_18112019.pdf)

<sup>ii</sup>[https://www.casemine.com/judgement/in/60b7617989082145be7efc5a#p\\_61](https://www.casemine.com/judgement/in/60b7617989082145be7efc5a#p_61)

<sup>iii</sup><https://ibclaw.in/section-5-definitions-under-part-ii-part-ii-insolvency-resolution-and-liquidation-for-corporate-persons-the-insolvency-and-bankruptcy-code-2016-ibc-sections/>

<sup>iv</sup>WOOD, Law and Practice of International Finance

<sup>v</sup>[https://www.indiacode.nic.in/show-data?actid=AC\\_CEN\\_3\\_20\\_00035\\_187209\\_1523268996428&sectionId=38684&sectionno=128&orderno=129](https://www.indiacode.nic.in/show-data?actid=AC_CEN_3_20_00035_187209_1523268996428&sectionId=38684&sectionno=128&orderno=129)

<sup>vi</sup><https://www.casemine.com/judgement/in/5609ab52e4b014971140c378>

<sup>vii</sup>[https://www.indiacode.nic.in/show-data?actid=AC\\_CEN\\_3\\_20\\_00035\\_187209\\_1523268996428&sectionId=38690&sectionno=134&orderno=135#:~:text=The%20surety%20is%20discharged%20by,discharge%20of%20the%20principal%20debtor.](https://www.indiacode.nic.in/show-data?actid=AC_CEN_3_20_00035_187209_1523268996428&sectionId=38690&sectionno=134&orderno=135#:~:text=The%20surety%20is%20discharged%20by,discharge%20of%20the%20principal%20debtor.)

<sup>viii</sup><https://www.casemine.com/judgement/in/5609ac05e4b014971140dced>

<sup>ix</sup><https://www.casemine.com/judgement/in/612f5b12342cca3e0c0cd7f3>

<sup>x</sup><https://www.casemine.com/judgement/in/5dc0774f3321bc77c508f3f9#52>

<sup>xi</sup>[https://www.indiacode.nic.in/show-data?actid=AC\\_CEN\\_2\\_11\\_00055\\_201631\\_1517807328273&orderno=36](https://www.indiacode.nic.in/show-data?actid=AC_CEN_2_11_00055_201631_1517807328273&orderno=36)

<sup>xii</sup>[https://www.indiacode.nic.in/show-data?actid=AC\\_CEN\\_2\\_11\\_00055\\_201631\\_1517807328273&orderno=39](https://www.indiacode.nic.in/show-data?actid=AC_CEN_2_11_00055_201631_1517807328273&orderno=39)

<sup>xiii</sup>[https://www.indiacode.nic.in/show-data?actid=AC\\_CEN\\_2\\_11\\_00055\\_201631\\_1517807328273&sectionId=874&sectionno=95&orderno=119](https://www.indiacode.nic.in/show-data?actid=AC_CEN_2_11_00055_201631_1517807328273&sectionId=874&sectionno=95&orderno=119)

<sup>xiv</sup>[https://www.indiacode.nic.in/show-data?actid=AC\\_CEN\\_2\\_11\\_00055\\_201631\\_1517807328273&orderno=120](https://www.indiacode.nic.in/show-data?actid=AC_CEN_2_11_00055_201631_1517807328273&orderno=120)

<sup>xv</sup><https://ibclaw.in/section-99-submission-of-report-by-resolution-professional/>

For general queries or to submit your research for publication, kindly email us at [editorial@ijalr.in](mailto:editorial@ijalr.in)

<https://www.ijalr.in/>

© 2023 International Journal of Advanced Legal Research