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### SUPREME COURT UPHOLDS NCLAT JUDGMENT RULING THAT INSOLVENCY PROCEEDINGS MAY BE INVOKED AGAINST CORPORATE GUARANTOR BEFORE PROCEEDING AGAINST THE PRINCIPAL DEBTOR

14 February 2019

On 11 February 2019, the Supreme Court dismissed the Civil Appeal bearing No. 1484 of 2019 filed by Rai Bahadur Shree Ram and Company Pvt. Ltd. (the shareholder and promoter of Ferro Alloys Corporation Limited) and affirmed the landmark judgment passed by the National Company Law Appellate Tribunal (NCLAT) in the matter of *Ferro Alloys Corporation Limited v Rural Electrification Corporation Limited (Comp. App (AT) (Ins) No. 92 of 2017)* and other connected appeals, in favour of Rural Electrification Corporation Limited (REC), the financial creditor.

In the said decision, the Supreme Court affirmed the NCLAT judgment which held that insolvency proceedings against the corporate guarantor may be undertaken without initiating prior proceedings against the principal debtor under the Insolvency and Bankruptcy Code 2016 (Code).

#### Facts

In the present case, REC served as a financial creditor and had sanctioned a loan amounting to INR 517.90 Crores to FACOR Power Limited, the principal debtor. Ferro Alloys Corporation Limited (Ferro Alloys) was the corporate guarantor of the said loan and had, therefore, undertaken to guarantee all amounts payable by FACOR Power Limited to REC. When FACOR Power Limited failed to repay the loan, REC invoked the corporate guarantee against Ferro Alloys on 27 October 2015. Thereafter, on the failure of Ferro Alloys to repay the loan, REC filed an Application under Section 7 of the Code before the National Company Law Tribunal, Kolkata (NCLT) to initiate corporate insolvency resolution proceedings against Ferro Alloys. NCLT passed an order in favour of REC admitting the application and appointed an interim resolution professional. Ferro Alloys filed an appeal before the NCLAT impugning the NCLT order. Thereafter, two other appeals were filed on behalf of a consortium of banks (Lenders Consortium) and Rai Bahadur Shree Ram and Company Pvt. Ltd, the shareholder and promoter of Ferro Alloys.

#### Arguments before NCLAT

The appellants submitted that while the Code includes the concept of a 'personal guarantor', it does not recognize the concept of a corporate guarantor. Therefore, an insolvency proceeding cannot be initiated against a corporate guarantor. Without conceding that a 'corporate guarantor' is subsumed within the definition of a 'corporate debtor', the appellants further contended that an insolvency proceeding cannot be

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initiated against the corporate guarantor without proceeding and exhausting the relief provided against the principal debtor.

On the other hand, REC submitted that the corporate guarantee provided by Ferro Alloys was unconditional, joint and several and co-extensive with that of the principal debtor and could be invoked even without exhausting the remedies against the principal debtor. It was further argued that a corporate guarantor becomes a corporate debtor as soon as a guarantee agreement is invoked. REC also argued that on a joint reading of Section 3(8) of the Code (which defines a 'Corporate Debtor' as "a corporate person who owes a debt to any person") and Section 5(8) of the Code (which defines 'Financial Debt' as inter-alia, including "the amount of any liability in respect of any of the guarantee") confirmed that a corporate person who owes a debt in the form of a liability in respect of a guarantee would be included in the definition of a "corporate debtor" under Section 3(8) of the Code.

### Judgment passed by the NCLAT

NCLAT held that:

- A joint reading of the definitions of corporate person, corporate debtor, debt, claim, financial debt, operational debt, financial creditor, and default provides that "a guarantee becomes a debt as soon as the guarantee is invoked whereinafter a guarantor ('corporate guarantor') becomes a 'corporate debtor'" in terms of the Code. In providing its judgment, NCLAT referred to *Bank of Bihar Limited v Dr. Damodar Prasad & Anr* ((1969) 1 SCR 620) (Bank of Bihar Case), which held that the liability of the surety under Section 128 of the Indian Contract Act, 1872 (Contract Act) is coextensive with that of the principal debtor. In addition, NCLAT also relied on *Ram Bahadur Thakur v Sabu Jain Limited* (1981 (51) Comp Cas 301) and *Kesoram Industries and Cotton Mills v Commissioner of Wealth Tax* ((1966) 59 ITR 767) to support its position.
- The Code does not bar a 'financial creditor' from initiating 'corporate insolvency resolution process' against the 'guarantor', who comes within the meaning of 'corporate debtor'. In the absence of any express provisions prescribing inter-se rights, obligation and liabilities of a guarantor qua a 'financial creditor', it was held that the provisions of the Contract Act may be relied upon for the same.
- It is always open to a 'financial creditor' to initiate resolution process under Section 7 of the Code against a 'corporate guarantor', as the creditor is also the 'financial creditor' qua 'corporate guarantor'. Here, NCLAT relied on the Bank of Bihar Case and *State Bank of India v Indexport Registered* ((1992) 3 SCC 159), wherein it has been held that the liability of surety is not to be deferred until the creditor exhausts his remedies against the principal debtor.
- It is also relevant to note that the appeal at the instance of Ferro Alloys through its board of directors (suspended) was held to be not maintainable in view of the judgment in *Innovative Industries Limited v. ICICI Bank* ((2018) 1 SCC 407), wherein the Supreme Court held that the board of directors (suspended) have no right to move an appeal on behalf of the 'corporate debtor', although it is open to the director(s) or shareholder(s) to challenge the same.

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## Comment

The Supreme Court has upheld and reaffirmed a long line of precedents under Indian and foreign contract and insolvency laws, which hold that a creditor may proceed against the guarantor on failure of the principal debtor to repay the loan upon demand by the creditor without exhausting his remedies against the principal debtor. If the argument of the appellants had been accepted, it would not only amount to rewriting the contract, but also reading provisions into a statute which is impermissible.

It is pertinent to note that the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018 amended the Code to bring in Section 5A which defined 'corporate guarantor' as a corporate person who is the surety in a contract of guarantee to a corporate debtor. Section 60 of the Code has also been amended to provide for the same Adjudicating Authority to deal with the insolvency resolution or liquidation processes of the corporate debtor and its corporate guarantor. In view of the same, the argument that the Code does not recognize the concept of a 'corporate guarantor' along with the argument that an insolvency proceeding cannot be first initiated against the corporate guarantor without proceeding and exhausting the relief provided against the principal debtor becomes redundant and was therefore rejected by the Supreme Court.

Khaitan & Co represented Rural Electrification Corporation in the appeals.

- *Vanita Bhargava (Partner), Wamika Trehan (Senior Associate), Zacarias Joseph (Associate) and Shweta Kabra (Associate)*

For any queries please contact: [editors@khaitanco.com](mailto:editors@khaitanco.com)

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### Mumbai

One Indiabulls Centre, 13<sup>th</sup> Floor  
Tower 1 841, Senapati Bapat Marg  
Mumbai 400 013, India

T: +91 22 6636 5000  
E: [mumbai@khaitanco.com](mailto:mumbai@khaitanco.com)

### New Delhi

Ashoka Estate, 12th Floor  
24 Barakhamba Road  
New Delhi 110 001, India

T: +91 11 4151 5454  
E: [delhi@khaitanco.com](mailto:delhi@khaitanco.com)

### Bengaluru

Simal, 2nd Floor  
7/1, Ulsoor Road  
Bengaluru 560 042, India

T: +91 80 4339 7000  
E: [bengaluru@khaitanco.com](mailto:bengaluru@khaitanco.com)

### Kolkata

Emerald House  
1 B Old Post Office Street  
Kolkata 700 001, India

T: +91 33 2248 7000  
E: [kolkata@khaitanco.com](mailto:kolkata@khaitanco.com)