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ARTICLE

Evolution of Personal Guarantor Insolvency Regime in India

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Synopsis

In 2016, the Insolvency and Bankruptcy Code, 2016 ('IBC') was enacted in India with the fundamental objective of remedying the issue of bludgeoning non-performing or stressed assets in the banking and finance sector. Unlike in case of insolvency resolution of corporate persons, the Indian Government has been adopting a 'wait and watch' approach and has been implementing provisions pertaining to insolvency resolution/bankruptcy of natural persons in a phased manner presumably taking into account the various social sensitivities involved in relation to insolvency resolution/bankruptcy of natural persons in addition to simpliciter economic considerations. After much wait, the Central Government by way of a notification dated 15 November 2019, notified the provisions pertaining to insolvency resolution/bankruptcy of natural persons effective from 1 December 2019 ('Notification') *only in so far as they relate to natural persons who have acted in the capacity of personal guarantors of corporate debtor* with a view to experiment and bring into force Part III of the IBC, which deals with insolvency of individuals and partnerships in phases.

However, right from the very constitutionality of the Notification to deciding the appropriate forum for instituting proceedings against personal guarantors, the jurisprudence in relation to treatment of personal guarantors under the scheme of the IBC has been in a state of constant evolution from its inception. In fact, even as on this date, there are several teething issues which have yet remain unresolved. In this paper we attempt to trace the jurisprudence relating to insolvency of personal guarantors by analysing certain landmark judicial pronouncements and bring out the nuances relating to insolvency of personal guarantors of corporate debtors, which now occupies a position much different from that of natural persons acting as principal borrowers.

Introduction

In 2016, the Indian Parliament enacted the Insolvency and Bankruptcy Code, 2016 ('IBC') with the fundamental objective of remedying one of the biggest predicaments faced by the banking and finance market in India i.e., mounting non-performing[1] or stressed assets. Enacted pursuant to the recommendations of the Bankruptcy Law Committee *vide* its report dated 4 November 2015, [2] IBC was aimed to act as an umbrella legislation and a one stop solution for the resolution of stress in all types of persons, whether natural or legal (including individuals, companies, limited liability partnership and partnerships), against the backdrop of a myriad and inefficacious legal system governing insolvency resolution, consisting of a multiplicity of laws such as the Companies Act, 2013, Sick Industrial Companies Act, 1985 (now repealed), Provincial Insolvency Act, 1926, Presidency Towns Insolvency Act, 1920 etc. (together 'Insolvency Acts'), which grossly failed to achieve time-bound resolution of stressed assets.[3]

IBC has contributed substantially to ushering in an efficacious and expeditious consolidated legal regime for resolution of insolvency amongst corporates, being companies and limited liability partnerships. As per the 6th Report of Standing Committee, Ministry of Corporate Affairs, as on 30 November 2019, out of claims of around USD 110.11 Billion filed by creditors in relation to the corporate insolvency resolution process ('CIRP') of various corporate debtors, the realisable amount was nearly around USD 46.5 billion ie over

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1 Non-performing assets is another term for bad assets and in the Indian context refer to an extended period for which any payment from a borrower to a licensed financier (such as a scheduled commercial bank or a non-banking financial company) remains overdue in relation to a loan or an advance. For instance, in case of scheduled commercial bank, a loan account is required to be classified and recognised as a non-performing asset if any principal or interest remains overdue for a period of 90 days or more.

2 The report of the Bankruptcy Law Reforms Committee Volume I: Rationale and Design dated 4 November 2015, available at https://ibbi.gov.in/uploads/resources/BLRCReportVol1_04112015.pdf (Last visited on 27 December 2019).

3 Wadhwa Law Chambers, *Guide to Insolvency & Bankruptcy IBC*, Vol.1, p.xi,(2019).

43%.[4] This is a substantial increase from the dismal average recovery of approximately 26% under the winding up regime which existed within the framework of Companies Act, 2013. Additionally, the average time taken for resolution has now come to about 394 days, closer to the timeline of 330 days prescribed in the IBC down as compared to 4.3 years under the previous regime.[5] Lastly, thanks to IBC, the performance of India in the World Bank's ease of doing business index improved remarkably from 142nd position in 2015[6] to 63rd position in 2019.[7]

However, while the CIRP regime has achieved tangible success, the issue of insolvency resolution for natural persons and partnerships (other than limited liability partnerships) has remained vexatious since the inception of IBC. This largely emanates from the fact that Part III of the IBC which deals with insolvency resolution for individuals and partnerships remained unnotified for the part of IBC's journey in India. Right from its inception, the IBC has enabled creditors to institute proceedings under Section 7 (for financial creditors) or Section 9 (for operational creditors) of the IBC against corporate persons which have either availed any amounts in the form of financial debt or issued guarantees to secure such debt. Accordingly, the jurisprudence in relation to treatment of corporate guarantors under the scheme of the IBC has been in a state of constant evolution from the its inception. On the other hand, while the scheme of the IBC contains exhaustive provisions for insolvency resolution of natural persons under Part III of the IBC, the same were not notified immediately. It was only, after a lapse of nearly three years, that the Central Government, while exercising its power under Section 1(3) of the IBC,[8] issued a notification on 15 November 2019, and made applicable, the provisions of Part III of the IBC effective from 1 December 2019 *only in so far as they relate to natural persons who have acted in the capacity of personal guarantors of corporate debtor* with a view to experiment and bring into force Part III of the IBC, which deals with insolvency of individuals and partnerships in phases ('Notification').

However, the introduction of the insolvency regime for natural persons, albeit in relation to only personal guarantors, has not been without challenges. The constitutionality of the Notification and the legal competence of the Central Government in extending the applicability of Part III of the IBC only to personal guarantors, was challenged before the Hon'ble Supreme Court ('Supreme Court') of India in the matter of *Lalit Kumar Jain v Union of India and Ors*[9] ('*Lalit Kumar Jain*'), *inter-alia*, on the ground that the Central Government has exceeded its authority and made modifications to Part III of IBC, which is not within its powers. It was further contended that IBC is a conditional legislation where the law is already enacted by the legislature, and the only power provided to the Central Government as the executive under Section 1(3) of the IBC is to bring in force different provisions of IBC on such dates as it may decide. IBC does not give Central Government, the authority to limit the applicability of the provisions to certain categories or class of people as the law itself does not provide any distinction between a personal guarantor to a corporate debtor or any other individual. The argument was further extended to say that even if such a power is assumed to be present in section 1(3), it would tantamount to an unconstitutional delegation of power. The Supreme Court, vide its order dated 21 May 2021, rejected these contentions, and upheld the constitutional validity of the Notification, *inter-alia*, on the grounds that:

(a) the intent of the Central Government has been to treat the personal guarantors as a different category of natural persons from other categories of individuals. The close connection between such individuals and corporate entities to whom they stood guarantee, as well as the possibility of 2 (two) separate processes (ie CIRP of corporate debtor and insolvency of personal guarantor) being carried on in different fora, with its attendant uncertain outcomes prompted the Central Government to carve out personal guarantors as a separate species of individuals; and

(b) the Notification does not appear to be a case of legislative exercise or impermissible and selective application of the provisions. The Central Government has the authority to follow a stage-by-stage process of bringing into force the provisions of IBC by placing due regard to the similarities or dissimilarities of the subject matter and the different categories of persons covered under IBC.

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4 Paragraph 2.3, Standing Committee on Finance – Ministry of Corporate Affairs, Insolvency and Bankruptcy (Second Amendment) Bill, 2019, 6th Report, March 2020 available at https://www.ibbi.gov.in/uploads/whatsnew/20ef77b3a1200f12ad19cee1c2c3dba9.pdf (last visited on 11 April 2022).

5 *Supra* Note 3.

6 World Bank Group, *Doing Business* 2015,available at https://www.doingbusiness.org/content/dam/doingBusiness/media/Annual-Reports/English/DB15-Full-Report.pdf (last visited on 11 April 2022).

7 World Bank Group, Doing Business 2020, available at https://openknowledge.worldbank.org/bitstream/handle/10986/32436/9781464814402.pdf (last visited on 11 April 2022).

8 Section 1(3) of the IBC provides that different provisions of the Code may come into effect on such date as may be appointed by the Government of India by issuing a notification in the official gazette.

9 Transferred Case (Civil) No. 245/2020.

In addition to the affirmation of constitutional validity of the Notification in *Lalit Kumar Jain*, the Supreme Court also observed that post the Notification, proceedings against personal guarantors can only be instituted under IBC and not under the extant Insolvency Acts (albeit Section 243 of the IBC repealing the Insolvency Acts has not been notified yet).

These observations gave fillip to the rapid evolution of jurisprudence in relation to insolvency resolution of personal guarantors of corporate debtors. However, despite the notification of Part III of IBC vis-à-vis personal guarantors, there are still many crucial legal issues which have yet remain unresolved. Additionally, recently the Ahmedabad bench of the Debt Recovery Tribunal in India ('DRT') in the matter of *State Bank of India v Prashant S. Ruia and Anr*[10] ('*Prashant Ruia*') shined the spotlight on the implications of some of the most commonly followed structures proposed in resolution plans, on the personal guarantors of the concerned corporate debtors.

In this paper we attempt to trace this jurisprudence and analyse certain landmark judicial pronouncements and attempt to address some of the teething legal issues relating to insolvency of personal guarantors, which still remain unresolved or at the very least still beg clarity. While the focus of this article is on personal guarantors of corporate debtors, the authors shall routinely juxtapose the legal issues discussed in this paper with judicial precedents laid down in the context of corporate guarantors providing holistic context.

Forum for instituting proceedings against the guarantor of corporate debtor

In terms of the IBC, the creditors have to approach National Company Law Tribunal ('NCLT') for insolvency and liquidation proceedings of corporate persons and DRT for insolvency and bankruptcy of individuals and firms. The Code also clarifies that if NCLT has a jurisdiction on a matter, then DRT cannot hear that matter. However, there are some exceptions to this rule and ever since the Central Government's Notification came into effect, one issue which remains a subject of discussion and debate is in relation to the appropriate Adjudicating Authority for entertaining applications against personal guarantors under Section 95 of the IBC.

Section 179 of the IBC stipulates *that subject to the provisions of Section 60 of the IBC*, the Adjudicating Authority in relation to insolvency matters of individuals and firms shall be the DRT having territorial jurisdiction over the place where the individual debtor actually and voluntarily resides or carries on business or personally works for gain.[11] As regards Section 60 of the IBC, the Supreme Court in *Lalit Kumar Jain* held that: (a) as per Section 60(2), an application for resolution process or bankruptcy of the personal guarantor to the corporate debtor is required to be filed with the concerned NCLT seized of the CIRP or liquidation process against the concerned corporate debtor. Accordingly, the Adjudicating Authority for personal guarantors will be the NCLT, *if a parallel resolution process or liquidation process is pending in respect of a corporate debtor for whom the guarantee is given*; (b) Similarly, under Section 60(3) of the IBC, where any insolvency and bankruptcy proceedings are pending against personal guarantors of a corporate debtor in a court or tribunal and a resolution process or liquidation is initiated against the corporate debtor, then the proceedings against personal guarantor shall be transferred to the NCLT seized of the resolution process or liquidation of such corporate debtor. Furthermore, the Supreme Court in *Lalit Kumar Jain* observed that Section 60(2) of the IBC has a non-obstante clause and hence overrides Section 60(1) of the IBC. The Supreme court further held that Section 60(2) is without prejudice to Section 60(1) of the IBC[12] and notwithstanding anything to the contrary contained in the IBC, thus giving overriding effect to Section 60(2) as far as it provides that the application relating to insolvency resolution or bankruptcy of personal guarantors of such corporate debtors shall be filed before the NCLT *where proceedings relating to corporate debtors are pending*.

However, it is relevant to note that until a recent Supreme Court order dated 6 May 2022 giving some finality to the jurisdiction issue in the matter of *Mahendra Kumar Jajodia Etc. v State Bank of India, Stressed Asset Management Branch*[13] ('6 May Order') (discussed in detail below), there have been conflicting judgments by various NCLTs and the High Courts which have created ambiguity with regard to the jurisdiction of the NCLT and DRT over insolvency of personal guarantors. These judicial decisions are discussed below.

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10 Original Application No. 648 of 2018.

11 Section 179(1) of the IBC reads as under:
'Subject to the provisions of section 60, the Adjudicating Authority, in relation to insolvency matters of individuals and firms shall be the Debt Recovery Tribunal having territorial jurisdiction over the place where the individual debtor actually and voluntarily resides or carries on business or personally works for gain and can entertain an application under this Code regarding such person.'

12 Section 60(1) of the IBC reads as under:
'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 a corporate person is located.'

13 Civil Appeal No(s). 1871-1872/2022.

– In the matter of *KEB Hana Bank v Mr. Rohit Nath*[14] ('*KEB Hana Bank*'), the Chennai bench of the DRT was examining whether it can entertain the application under Section 95 of the IBC considering that the principal borrower was not under CIRP. The DRT-Chennai held that Section 60 of the IBC does not have any application when proceedings have been instituted by treating a DRT as the jurisdictional authority under Section 179 of the IBC and accordingly, proceedings against personal guarantors can be instituted against personal guarantors before jurisdictional DRT, even though insolvency proceedings against the principal corporate debtor is not filed/pending before the NCLT. In other words, DRT-Chennai acknowledged that in a situation where an application for CIRP has not been filed/pending before NCLT, the DRT can exercise jurisdiction as the Adjudicating Authority under Section 179 of the IBC and adjudicate an application under Section 95 of the IBC. This decision of the DRT was subsequently upheld in the matter of *Rohit Nath v KEB Hana Bank Limited*[15] whereby the Hon'ble Madras High Court held that in the event there is no CIRP initiated in respect of a corporate debtor, then the insolvency proceedings pertaining to the personal guarantor of such corporate debtor *must necessarily be carried out only to the jurisdictional DRT and not in any other forum.* Similarly, the Mumbai bench of the NCLT ('NCLT-Mumbai') in the matter of *Insta Capital Private Limited v Ketan Vinod Kumar Shah*[16] ('*Insta Capital*'), placed reliance on Section 60(2) of the IBC[17] and held that an application can be filed for insolvency resolution of a personal guarantor under Section 95 of the IBC before NCLT *only where a CIRP process or liquidation process of the concerned corporate debtor is pending before the Adjudicating Authority ie the NCLT.*

– In another matter of *Altico Capital India Limited v Rajesh Patel and Ors*[18] ('*Alitco Capital*'), the NCLT-Mumbai took a similar view, by dismissing an application filed under Section 95 of the IBC against a personal guarantor on the sole ground that the corporate guarantor for which the personal guarantee was given by the said personal guarantor was not under CIRP and therefore, an application under Section 95 is not maintainable before the NCLT. However, subsequently in the matter of *PnB Housing Finance Ltd v Mr. Mohit Arora*,[19] the New Delhi Bench of the NCLT ('NCLT-New Delhi') placed reliance on Section 60(1) of the IBC[20] and diluted the observations of NCLT-Mumbai in the matters of *Insta Capital* and *Altico Capital* to hold that when an application *in relation to a corporate debtor* for initiation of CIRP is pending before the NCLT, then initiation of CIRP of such corporate debtor is not a prerequisite for maintainability of an application under Section 95 of the IBC before the NCLT. In other words, the NCLT-New Delhi held that for maintainability of an application under Section 95 of the IBC before NCLT, a mere filing of an application under Sections 7, 9 or 10 of the IBC is sufficient and that actual commencement of CIRP is not a prerequisite.

  In other words, it has been laid down by various tribunals that in terms of Sections 60(2) and 60(3) of the IBC, the NCLT would be the appropriate forum to institute proceedings against the personal guarantor only in the event parallel proceedings have at least been filed for the initiation of CIRP against principal borrower before the jurisdictional NCLT. In the event, there are no parallel proceedings against principal borrower, the appropriate adjudicating authority appears to be DRT.

– However, the Hon'ble National Company Law Appellate Tribunal ('NCLAT') in the matter of *State Bank of India, Stressed Assets Management Branch v Mahendra Kumar Jajodia, Personal Guarantor to the Corporate Debtor*[21] ('*Mahendra Kumar*') set aside the judgment of Kolkata bench of the Hon'ble National Company Law Tribunal ('NCLT-Kolkata') which followed the decision of NCLT-Mumbai in *Insta Capital* and *Altico Capital* and held that Section 60(1) of the IBC *simpliciter* stipulates that

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14 IBC SR.NO 2643/2020.
15 2021 SCC OnLine Mad 2734.
16 CP (IB)/ 1365/MB-IV/2020.
17 Section 60(2) of the IBC reads as under:
'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 1[liquidation or bankruptcy of a corporate guarantor or personal guarantor, as the case may be, of such corporate debtor] shall be filed before the National Company Law Tribunal'
18 I.A No. 1062/2021 in C.P.No. 293/2020.
19 Company Petition No. (IB)-395(ND)2021.
20 Section 60(1) of the IBC reads as under:
'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 a corporate person is located.'
21 Company Appeal (AT) Insolvency No. 60 of 2022.

the Adjudicating Authority in relation to CIRP of personal guarantors of corporate debtor shall be NCLT. Accordingly, initiation/ pendency of CIRP / liquidation proceedings against principal borrower is not pre-requisite for an NCLT to entertain an application under Section 95 of the IBC against a personal guarantor.

– In a subsequent decision in the matter of *Shapoorji Pallonji Finance Private Limited v Rekha Singh*[22] ('*Shapoorji Pallonji*'), the Jaipur bench of the NCLT ('NCLT-Jaipur') followed the decision of *Mahendra Kumar* and held that : (a) CIRP can be instituted against a personal guarantor before NCLT to a corporate debtor irrespective of whether CIRP has been instituted against a corporate debtor; and (b) the judgments of NCLT-Mumbai in *Altico Capital* and *Insta Capital* are per-incuriam in light of the observations of the NCLAT in *Mahendra Kumar.*

In other words, *Mahendra Kumar* and *Shapoorji Pallonji* deviated from the earlier jurisprudence on this issue and observed that an application under Section 95 of the IBC can be instituted against a personal guarantor of a corporate debtor before the NCLT even before filing/institution of an application under Sections 7, 9 and 10 of the IBC against the Corporate Debtor.

This issue how now achieved finality as the Supreme Court has upheld the NCLAT's judgment in *Mahendra Kumar vide* its 6 May Order. Pursuant to this decision of the Supreme Court, it now appears to be a settled position of law that an application under Section 95 of the IBC can be instituted by a creditor against a personal guarantor of a corporate debtor even before filing/institution of an application under Sections 7, 9 and 10 of the IBC against the corporate debtor.

A necessary corollary of this judgment appears to be that if a natural person has given a guarantee to secure the debt of a corporate debtor, then under all circumstances, irrespective of whether an application for commencement of CIRP has been instituted against such corporate debtor, the appropriate forum for instituting insolvency resolution process against such natural person would be the NCLT having territorial jurisdiction over the registered office of such natural person/ personal guarantor. However, a question arises as to whether the 6 May Order completely ousts the jurisdiction of DRT in relation to insolvency resolution of personal guarantors of a corporate debtor. If this analogy stands, then the DRT would be an appropriate forum for individuals only to the extent of instituting insolvency proceedings against natural persons as principal borrowers (as and when the provisions of Part III of the IBC are extended to them) and not as personal guarantors.

Relevance of the nature of principal borrower

As stated in the article earlier, the current personal insolvency regime for natural persons is restricted to personal guarantors to corporate debtors ie individuals who have extended guarantees in favor of creditors to secure debt of a company or a limited liability partnership. In this context, for reasons discussed below, it remains unsettled as to whether the nature of the principal borrower is relevant for invoking the provisions of IBC against the personal guarantor in question.

In one of the first notable cases where the nature of principal borrower became relevant for examination from the perspective of initiating insolvency against another person, albeit not an individual, was in the case of *Laxmi Pat Surana v Union Bank of India and Anr*,[23] where the Supreme Court examined the issue of whether the principal borrower is required to be a qualified 'corporate person' for entertaining an application for initiation of CIRP against the corporate guarantor under IBC. Answering the question in the negative, the Supreme Court held that if a corporate person extends guarantee for a debt availed by a person who is not a corporate person then the said entity as a corporate guarantor would still be covered within the meaning of the expression 'corporate debtor' under the IBC and that an application under Sections 7, 9 and 10 of the IBC can be instituted against such corporate guarantor.

Although in the case of personal guarantors of the corporate debtor while the Supreme Court has not yet tested this question, it is interesting to note that the NCLT-Jaipur in the matter of *Shapoorji Pallonji* dealt with the issue of whether insolvency resolution process can be instituted against personal guarantor of a financial service provider. For the purpose of understanding this in detail, it would be relevant to note that a financial service provider (ie an entity or a person engaged in the business of providing financial services[24] in terms of authorisation issued or registration granted by a financial sector regulator) is an exception to the general rule of the provisions of CIRP under IBC being applicable to all corporate persons. To put things into

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22 IA No. 229/JPR/2021 in CP No. (IB) 25/95/JPR/2021.

23 Civil Appeal No. 2734 of 2020.

24 As per Section 3(16) and 3(17) of the IBC, 'financial service provider' refers to a person who is engaged in the business of inter-alia following services: (a)accepting of deposits; (b) safeguarding and administering assets consisting of financial products, belonging to another person, or agreeing to do so; (c) effecting contracts of insurance; (d) offering, managing or agreeing to manage assets consisting of financial products belonging to another person; (e) rendering or agreeing, for consideration, to render advice on or soliciting for the purposes of (i) buying, selling, or subscribing to, a financial product; (ii) availing a financial service; or (iii) exercising any right associated with financial product or financial service; (f) establishing or operating an investment scheme; (g) maintaining or transferring records of ownership of a financial product; (h)

perspective, Thus, provisions relating to insolvency and liquidation of corporate persons are currently applicable (with certain modifications) against only those Non Banking Financial Companies registered with the RBI, which have the asset size as mentioned above. The question which thus arises that if an individual personal guarantor has issued a guarantee for a corporate person which is a financial service provider; but does not meet the aforesaid criteria, whether an insolvency proceeding can be initiated against such personal guarantor.

When this issue was taken up in *Shapoorji Pallonji* the personal guarantor in that matter argued that the Notification has made Part III of the IBC (which deals with insolvency of individuals) applicable only in relation to personal guarantors of the Corporate Debtor and the corporate entity on whose behalf the guarantee was issued in that matter was a financial service provider but was not subject to a CIRP process under IBC. The personal guarantor further argued that if the principal borrower in relation to which a personal guarantee is issued does not qualify as a 'corporate debtor', then an application under Section 95 of the IBC cannot be admitted against the personal guarantor. NCLT Jaipur, while accepting these submissions, made the following observations:

(a) Unlike in case of corporate guarantor where the nature of principal borrower is immaterial, in case of an application under Section 95 of the IBC, the principal borrower has to qualify as a 'corporate debtor';

(b) The Rules notified by the Central Government for the insolvency and liquidation of FSPs currently only apply to an NBFC with an asset size of INR 500 Crores and therefore, an application under Part III of the IBC can lie against personal guarantors of only such FSPs/ NBFCs.

Effect of resolution plan against personal guarantors

Section 31(1) of the IBC stipulates that a resolution plan submitted for a corporate debtor under CIRP, once approved by the Adjudicating Authority becomes binding on all the stakeholders of the concerned corporate debtor, *including its creditors and its guarantors.*[25] Therefore, it is worthwhile to examine the typical consequences of the provisions of an approved resolution plan vis-a-vis guarantor.

Pursuing remedies against personal guarantors post approval of resolution plan

The scope and extent of a personal guarantor's liability pursuant to the approval of a resolution plan was examined by the Hon'ble Supreme Court in the matter of *Lalit Kumar Jain.* The Hon'ble Supreme Court, placing reliance on its earlier decisions in the matters of *Maharashtra State Electricity Board Bombay v Official Liquidator, High Court, Ernakulum & Anr*[26] held that: (a) approval of a resolution plan against principal borrower under Section 31(1) of the IBC does not *per se* operate as a discharge of the guarantor's liability as the liability of a guarantor under the Indian is co-extensive to that of the principal borrower;[27] (b) a contract of guarantee is an independent contract and the nature and extent of liability of a personal guarantor post the approval of a resolution plan would depend on the terms of the guarantee itself.

In addition to the above, it is relevant to consider that the scope and extent of a creditor's right against a guarantor would depend upon the structure and manner in terms of which the debt of the principal borrower is resolved under a resolution plan. The issue of implication of the terms of settlement of principal debt under a resolution plan on the liability of the guarantor recently came up to be discussed before the DRT-Allahabad in *Prashant Ruia.* In the said matter, the resolution plan submitted by Arcelor Mittal India Private Limited ('AMIPL') for Essar Steel India Limited ('Essar Steel') stipulated that the successful resolution applicant (ie., AMIPL) shall acquire the entire debt of Essar Steel including its underlying securities (excluding corporate and personal guarantees issued for the benefit of Essar Steel) pursuant to making payment of an Indian Rupee equivalent of approximately USD 5.8 billion to the secured financial creditors of Essar Steel. Subsequently, relying on this provision of the resolution plan which provided for assignment of entire financial debt to the resolution applicant sans the guarantees, the secured creditors attempted to invoke the personal guarantee issued by the promoters of Essar Steel. Placing reliance on the judgment of the High Court of Australia in the matter of *Hutchens v Deauville Investments Pty Ltd*[28] the DRT-Ahmedabad held that the existence of an 'underlying debt' is a pre-condition for

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underwriting the issuance or subscription of a financial product; or (i) selling, providing, or issuing stored value or payment instruments or providing payment services;

25 Section 31(1) of the IBC reads as under:

26 1982 (3) SCC 358

27 Section 128 of the Indian Contract Act, 1872 reads as under: 'Surety's liability.—*The liability of the surety is co-extensive with that of the principal debtor, unless it is otherwise provided by the contract*'

28 68 Australian Law Reports 367

invoking the guarantee issued in relation to such debt when the entire debt of ESL has been assigned in favour of AMPIL under the terms of the resolution plan and no debt remains in the books of the secured financial creditors, then the secured financial creditors do not have any right to invoke the guarantee issued in relation to such debt.

It is relevant to note that the structure followed in the resolution plan of AMIPL is a fairly common structure followed by many resolution applicants for acquisition and resolution of stress of a corporate debtor. The judgment of DRT-Ahmedabad in *Prashant Ruia* has the invariable effect of compelling to resolution applicants and the committee of creditors of the corporate debtor to devise and consider alternative structures which preserve the right of the creditors to exercise their remedies against guarantees issued by the promoters of the concerned corporate debtor.

Per Contra, in the matter of *Committee of Creditors of Ushdev International Limited Through State Bank of India v Subodh Kumar Agarwal, Resolution Professional of Ushdev International Limited*[29] the resolution plan stipulated that the financial creditors of the concerned corporate debtor would be paid upfront cash payment towards a portion of their financial debt and the unpaid debt of the corporate debtor would be converted into preference shares issued in favour of the financial creditors. The resolution plan also stipulated pursuant to the payment of upfront cash and issuance of preference shares, the entire debt owed by corporate debtor towards its financial creditors shall be extinguished in full, *save and except 'excluded securities'* (ie., guarantees issued by the promoter entities of the corporate debtor). The NCLAT, while examining the issue of whether excluded securities are enforceable against the promoters held that the resolution plan expressly carves out excluded securities while extinguishing the rights of creditors in relation to the debt owed to them by the principal borrower. Accordingly, on a holistic reading of the resolution plan, it is clear that the liabilities of promoter under the excluded securities was never envisaged to be extinguished under the terms of the resolution plan and hence, the excluded securities are enforceable against the promoters. Curiously, unlike DRT-Ahmedabad, the NCLAT did not examine the issue of whether the 'underlying debt' in relation to the excluded securities continues to subsist pursuant to the conversion of unpaid debt into preference shares and issuance of such preference shares to the financial creditors.

Extinguishment of right of abrogation of guarantors

Where a guaranteed debt has become due, or default of the principal debtor to perform a guaranteed duty has taken place, the surety upon payment or performance of all that he is liable for, is invested with all the rights which the creditor had against the principal debtor.[30] In other words, Section 140 confers the guarantor with the right of 'subrogation' ie., when a guarantor makes payment to discharge the guaranteed debt, then the guarantor steps into the shoes of the creditor and can exercise the remedies available to such creditor against the principal borrower. However, in the matter of Committee of Creditors of *Essar Steel India Limited Through Authorised Signatory v Satish Kumar Gupta and Ors*[31] the Hon'ble Supreme Court was examining the issue of whether the 'subrogation' right of a guarantor can be extinguished under the terms of a resolution plan submitted for the principal borrower. Answering in the affirmative, the Hon'ble Supreme Court, placing reliance on its earlier judgment in the matter of *State Bank of India v V. Ramakrishnan*[32] held that Section 31(1) of the IBC makes it expressly clear that the terms of an approved resolution plan are binding on all stakeholders, *including guarantors* and accordingly, the term of a resolution plan which stipulates that the right of subrogation of a guarantor stands extinguished is valid and enforceable vis-à-vis the guarantor. As a corollary, while the right of creditors to exercise their remedies against guarantors may be preserved under a resolution plan, a guarantor cannot exercise its right of subrogation and exercise remedies against the corporate debtor if the creditors of the corporate debtor exercise their remedies against guarantors post the implementation of a resolution plan.

Concluding remarks

The notification of provisions pertaining to insolvency resolution of corporate persons has contributed substantially towards stressed asset resolution of corporate persons. Part III of the IBC, which deals with insolvency and bankruptcy of individuals and partnerships but presently restricted in application to personal guarantors, bears a similar promise in relation to insolvency resolution of personal guarantors of corporate debtors. The insolvency regime of personal guarantors is equally relevant for the domestic and international creditors who while evaluating and pricing the advances

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29 Company Appeal (AT)(Insolvency) No. 172-173 of 2022

30 Section 140 of ICA reads as under:
'Rights of surety on payment or performance – *Where a guaranteed debt has become due, or default of the principal debtor to perform a guaranteed duty has taken place, the surety, upon payment or performance of all that he is liable for, is invested with all the rights which the creditor had against the principal debtor.*'

31 Civil Appeal No. 8766-67 of 2019 and Ors

32 2018 (9) SCALE 597

to Indian companies also consider the strength of the balance sheet of the Indian promoters. The resolution of some of the issues mentioned in the foregoing paragraphs may provide fillip for the faster evolution of jurisprudence and the development of a seamless mechanism for insolvency resolution of personal guarantors. This would definitely go a long way in improving investor confidence as well as in improving credit accessibility for the Indian corporates.

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