

Lenders face a choice between debtor, guarantor

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Guarantee as a form of collateral security is popular in financing deals as the liability of a guarantor and the principal debtor are coextensive. Thus, the creditor has a remedy against both the principal debtor and the surety without the having to exhaust the remedy against one of the parties before proceeding against the other. Despite this well-established principle, the question of whether simultaneous proceedings can be initiated against the principal debtor and guarantor was the subject of debates under the Insolvency and Bankruptcy Code, 2016 (code).

The National Company Law Appellate Tribunal (NCLAT), in the Vishnu Kumar Agarwal v Piramal Enterprises Ltd case, did not allow simultaneous proceedings against corporate guarantors for the same debt. Piramal Enterprises, a financial creditor, had instituted a corporate insolvency resolution process (CIRP) against the two corporate guarantors – Sunrise Naturopathy and Resorts and Sunsystem Institute of Information Technology for a debt owed to it by All India Society for Advance Education and Research. It had not initiated a CIRP against the borrower. The NCLAT was faced with two questions – whether a CIRP can be initiated against corporate guarantors without initiating one against the principal borrower, and whether a CIRP can be initiated against two corporate guarantors simultaneously.

The NCLAT answered the first question in the affirmative. However, with regards to the second question, the NCLAT held that though there is no bar in the code for filing applications simultaneously, once one of the applications is admitted, the financial creditor cannot proceed against the others. The rationale was that the code does not have the provision for filing a joint application against multiple corporate debtors unless they are combined in a joint venture company. The NCLAT held that for the same set of debts, a claim cannot be filed by the same financial creditor in two separate CIRPs. This means the lender is barred from pursuing parallel proceedings and it cannot participate in the CIRP of both the borrower and the guarantor even if such proceedings or one of them have been initiated by any other creditor or by the debtor itself.

The NCLAT dismissed the CIRP against the first guarantor as a CIRP against the second guarantor had already been admitted. The NCLAT held that the once a CIRP is admitted against the second guarantor, the first guarantor can say that the debt in question is not due as it is not payable in law, because it has been shown that the debt is payable by the second guarantor. This reasoning goes against the law relating to guarantees, where the guarantors may be jointly or severally liable for the debt. The admission of claim against one cannot constitute extinction of the right against the other.

The NCLAT had, in the ICICI Bank v Vista Steel Private Limited case, allowed a CIRP against the respondent guarantor despite a CIRP being admitted against the borrower and a resolution plan approved for the borrower. Thus, it appears that the NCLAT has been taking contrary positions on the question of simultaneous proceedings against guarantors and borrower.

The Insolvency Law Committee (ILC), in a report, observed that having a remedy against both the surety and the debtor without the obligation to exhaust the remedy against one before proceeding against the other, is of utmost importance for the creditor and is the hallmark of a guarantee contract. The availability of such a remedy is in most cases the basis on which the loan may have been offered.

The ILC's observation was also relied upon by the Supreme Court in the State Bank of India v V Ramakrishnan & Ors case, albeit in the context of section 14 of the code, while arriving at the decision that a moratorium on a corporate debtor should not constitute a bar to the institution of proceedings against the personal guarantor.

The decision in the Piramal case, therefore, appears to be contrary to the cardinal principles of guarantees. Pursuant to this decision, the lenders seeking remedies under the code will now have to make a choice between the debtor and the guarantor. Further, the decisions where tribunals have allowed simultaneous proceedings are now open to challenge.

Simultaneous insolvency proceedings against the borrower and guarantor may result in complications especially where the CIRP of one of the parties is concluded while the other is still pending. To address these concerns, a framework for the consolidation of proceedings is needed. Denying the lender, the right to pursue simultaneous remedies may not be the answer.