

SUPREME COURT: PERSONAL GUARANTORS CAN BE MADE LIABLE UNDER INSOLVENCY CODE PRIOR TO ANY ACTION AGAINST PRINCIPAL BORROWER

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INTRODUCTION

A recent pronouncement of the Supreme Court in *Mahendra Kumar Jajodia v. State Bank of India (2022) ibclaw.in 32 SC* provides further clarity on the (a) right of creditors to initiate insolvency resolution process against personal guarantors of the principal borrower; and (b) timing and jurisdiction to exercise such a right. We have discussed these aspects below.

INSOLVENCY PROCEEDINGS AGAINST PERSONAL GUARANTORS

Earlier, the Insolvency and Bankruptcy Code, 2016 (“**IBC**”) did not recognize personal guarantors as a separate class of individuals against whom insolvency proceedings could be initiated. It was only after the enactment of the Insolvency and Bankruptcy Code (Amendment) Act, 2018, that personal guarantors were recognized as a separate class of individuals. The said amendment also empowered National Company Law Tribunal/s (“**NCLT/s**”) to act as the adjudicating authority for insolvency proceedings against personal guarantors of principal borrowers.

To further the objective of the above amendment, Part III of the IBC was made applicable to personal guarantors of principal borrowers by way of a notification dated November 15, 2019.^[1] As a result, creditors could initiate insolvency proceedings against personal guarantors before an NCLT under the amended Section 60(1) and (2),^[2] read with Section 95 of the IBC.

ORDER OF THE SUPREME COURT AND NCLAT

State Bank of India, a financial creditor (“**Creditor**”), filed an application for initiation of the insolvency resolution process (“**IRP**”) against *Mahendra Kumar Jajodia* and *Bhanwar Lal Jajodia*, Personal Guarantors to the corporate debtor (“**CD**”). The National Company Law Tribunal, Kolkata (“**NCLT-K**”) rejected the Creditor’s application on the basis that a corporate insolvency resolution process (“**CIRP**”) was not pending against the CD. The Creditor preferred an appeal to the National Company Law Appellate Tribunal (“**NCLAT**”). The NCLAT held that IRP could have been initiated against the Personal Guarantors regardless of whether a CIRP has been initiated against the CD. The

NCLAT further explained that an application initiating IRP against a personal guarantor can be filed before an adjudicating authority having territorial jurisdiction over the registered office of the principal corporate borrower.

Thereafter, the Personal Guarantors challenged the order of the NCLAT before the Supreme Court which confirmed the ruling and reasoning adopted by the NCLAT.

The initiation of IRP against personal guarantors to a corporate debtor are governed by the following principles:

- 1. A creditor can initiate IRP against personal guarantors to a corporate debtor prior, during and after the completion of the CIRP against the corporate debtor.*
- 2. An IRP against the personal guarantors would have to be filed before an NCLT which has territorial jurisdiction over the registered office of the CD and not a debt recovery tribunal (DRT).*

RAMIFICATIONS

Since the inception of the IBC, we have seen large corporate groups undergoing CIRP, like, Essar Steel, Videocon and ADAG group companies. In each of these case, multiple creditors had to take severe haircuts, and for some, nil payment was proposed as the payment offered by the resolution applicant was enough to only repay secured financial creditors. While some creditors, including public sector banks, faced huge fiscal losses, the promoter entities/individuals continued being financially sound.

The Supreme Court in *Lalit Kumar Jain v. Union of India* [\(2021\) ibclaw.in 61 SC](#) explained that the sanction of a resolution plan and the conclusion of a CIRP of the principal borrower does not discharge a guarantor from its liability to the creditor. Accordingly, creditors can initiate an IRP against personal guarantors after the CIRP of the principal borrower has concluded. Thus, if creditors believe they have acceded to excessive haircuts in a CIRP of the principal borrower, they are permitted to proceed against the personal guarantors as well.[\[3\]](#).

The present judgment of the Supreme Court clarifies that such creditors can now initiate insolvency proceedings against personal guarantors even before commencing a CIRP against the principal borrower. Therefore, it appears that creditors are now in a safer space with respect to realizing their dues.

Additionally, in an IRP against personal guarantors, an interim moratorium is imposed from the date of filing of an application.[\[4\]](#) During such interim moratorium, any legal action or proceeding in respect of any debt owed by the personal guarantor is stayed. As a result, other creditors of the personal guarantors cannot initiate any legal action, including enforcement of security interest, in respect of the personal guarantor's assets.

Further, in an IRP against personal guarantors, a creditor can nominate a resolution professional who prepares a report on whether the application should be admitted by the NCLT. Thereafter, the NCLT passes an order for acceptance or rejection of the creditor's application. This process can possibly be completed within a period of 30 days. An order accepting the initiation of the IRP implies that a moratorium is imposed in terms of Section 101 of the IBC. Such a moratorium shall bar the Personal Guarantor from transferring, alienating, encumbering or disposing any of his assets, legal rights or beneficial interest therein, which appears to be a severe consequence as the same can cause significant hardship to any individual. This might prompt promoters, standing as personal guarantors, to contemplate repaying the creditors as well as refraining from initiating frivolous litigation which delay the CIRP of the corporate debtor.

On the other hand, for creditors, it would be commercially prudent to obtain a personal guarantee by the promoters at the time of executing the lending agreement. Creditors can invoke such personal guarantee in the event of default by the corporate debtor, even without going against the corporate debtor itself.

Reference:

[1] Except some provisions pertaining to fresh start [Chapter II]

[2] [Section 60, IBC](#)

“60. (1) 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 the corporate persons is located.

(2) 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 [liquidation or bankruptcy of a corporate guarantor or personal guarantor, as the case may be, of such corporate debtor] shall be filed before such National Company Law Tribunal.”

[3] [Lalit Kumar Jain v. Union of India, \(2021\) ibclaw.in 61 SC.](#)

[4] [Section 96, IBC.](#)