

# CAN LIQUIDATOR'S OUTREACH GRAB GUARANTORS ASSETS

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**Editor's Note:** *Guarantee contracts are an extremely common phenomenon and is found in almost every company, more commonly amongst group companies. While under contract laws, the liability of guarantor is co-extensive with that of the principal debtor, issue arose as to whether it is possible to include the assets of the (personal) guarantor in the liquidation of the corporate debtor. In one of the cases, it was ruled that the assets of the guarantor can be subjected to liquidation.*

*Later, the ruling was reversed by Hon'ble NCLAT. The analysis by our colleague contains important point of law, and has been retained despite the NCLT ruling having been over-ridden.*

In [Punjab National Bank v. Vindhya Vasini Industries Limited](#), [C.P. ( IB)-1170(MB)] the issue before the NCLT, Mumbai Bench was whether a property belonging to the guarantor of the corporate debtor can be liquidated in the liquidation proceedings of the corporate debtor. The NCLT referred to section 60(2) of the Code and held that the assets of the guarantor can be subjected to liquidation by virtue of the said section. The rationale given by the NCLT was that the financial debt in question was intricately linked with the property of the guarantor mortgaged under the same loan agreement on the basis of which the financial debt in question was sanctioned and hence cannot be segregated in the process of liquidation proceedings.

With due respect to the decision of the NCLT, the author opines that while it is open for the creditors to proceed against the guarantor's assets independently and simultaneously, the NCLT's reliance on section 60(2) of the Code to support its ruling is altogether misplaced. The legislative intent behind section 60(2) is to ensure that there is a common forum for dealing with the insolvency resolution, liquidation process and bankruptcy of the corporate debtor and its personal guarantors, as the case may be. However, in the instant case, no question arose as to the insolvency or bankruptcy of the personal guarantor. Based on the loan agreement alone by way of which the properties of the guarantor were mortgaged to obtain the financial debt, the NCLT held that the liquidator is entitled to liquidate the assets of the guarantor too.

Given the context, the following may be noted as regards a guarantor's assets vis-à-vis proceedings under the Code:

## 1. Scope/intent of section 60 (2) of the Code

Section 60 of the Code provides for jurisdiction of NCLT. Sub-section (2) provides that where a corporate insolvency resolution process or liquidation proceeding of a corporate debtor is pending before a NCLT, 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 the same NCLT.

The NCLT, in the instant case, remarked:

*. . . to avoid such high percentage of sacrifice, it is necessary to take decision in favour of the financial creditor to initiate liquidation proceedings against a guarantor as well who had mortgaged the property and on that guarantee the loan in question was granted. The debt in question is intricately linked with the property mortgaged hence cannot be segregated in the process of liquidation proceedings. . . As a result, the assets of the guarantor can be subjected to liquidation by invoking the jurisdiction prescribed u/s 60(2) of the Code.*

In the opinion of the authors, the purport of section 60(2) is to provide a common forum for proceedings under the Code in respect of the corporate debtor and in respect of the guarantors (personal or corporate). The section does not intend to cover segregated recovery proceedings against the assets of the guarantors, like invocation of guarantee, and commingling the guarantor's assets with the assets comprised in the liquidation estate of the corporate debtor.

Hence, references to the above section in the instant case were completely irrelevant. There were no insolvency resolution/bankruptcy proceedings against the guarantor. There was no application for initiation of bankruptcy proceedings against the guarantor either. Simultaneously, it may be noted that the provisions of the Code relating to insolvency resolution/bankruptcy of individuals have not been enforced as yet. The above holds true whether or not the guarantee is extended under the same loan agreement under which the debt was advanced.

## **2. Guarantor's assets during resolution: drawing the analogy**

The guarantor's assets are not protected by the moratorium provisions of section 14 of the Code, as already made explicit by way of amendments made by the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018 to section 14 of the Code. The provisions of moratorium during corporate insolvency resolution process period shall not apply to a surety in a contract of guarantee to a corporate debtor. Therefore, the creditor can proceed against the assets of the surety (i.e. the guarantor) while the corporate insolvency resolution process is continuing in respect of the corporate debtor.

Prior to the said Ordinance, there were conflicting views of the National Company Law Appellate Tribunal ("NCLAT") and the High Court on the subject. See, [Alpha and Omega Diagnostics \(India\) Ltd. v. Asset Reconstruction Company of India](#) [Company Appeal (AT) (Insolvency) No. 116/2017]; [Schweitzer Systemtek India Private Limited v. Phoenix ARC Private Limited](#) [Company Appeal (AT) (Insolvency) No. 129/2017]; [Sanjeev Shriya v. State Bank of India](#) [2017 (9) ADJ 723]; [State Bank of India v. V. Ramakrishnan and Veelson Energy Systems](#) [Company Appeal (AT) (Insolvency) No. 213/2017].

The Insolvency Law Committee (ILRC), in its Report, had referred to section 128 of the Indian Contract Act, 1872 which establishes the co-extensiveness of the liability of the surety to that of the principal debtor. Thus, the creditor is entitled to proceed against either the principal borrower or surety or both in any order, unless a contrary stipulation has been made in the contract. It further noted that the assets of the surety are separate from those of the corporate debtor, and that the availability of remedy with the creditor against both the surety and the corporate debtor in a contract of guarantee is the basis for extending loans in most cases. In view

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of this, the ILRC recommended exclusion of the assets of the guarantor from the applicability of moratorium, which has been incorporated by the Ordinance as above.

By extending the same reasoning to the liquidation proceedings, it can be stated that a loan agreement, incorporating guarantee as a collateral, confers no power on the liquidator to liquidate the assets of the guarantor and any interpretation inconsistent with this would contravene the settled principle of contract law.

The above situation is evident of the fact that the assets of the guarantor do not form part of the assets of the corporate debtor (see below), and the creditors have a separate independent recourse against the guarantor, outside the liquidation proceedings.

### **3. Not a component of liquidation estate**

As regards the formation of liquidation estate for recovery, sub-sections (3) and (4) of section 36 of the Code enlist the assets which would fall or not fall, respectively, within the liquidation estate of the corporate debtor. The assets of guarantor are nowhere included in section 36(3). Moreover, there is express exclusion under sub-section (4) of personal assets of any shareholder or partner of a corporate debtor from the liquidation estate unless such assets are held on account of avoidance transactions. It follows that the guarantor's assets can only be put into the liquidation estate where the assets form a subject matter of vulnerable transactions, dealt with under sections 43 to 51 of the Code.

### **4. Can NCLT exercise its inherent powers to order the liquidation of the assets of the guarantor?**

Rule 11 of the National Company Law Tribunal Rules, 2016 reads:

*Nothing in these rules shall be deemed to limit or otherwise affect the inherent powers of the Tribunal to make such orders as may be necessary for meeting the ends of justice or to prevent abuse of the process of the Tribunal.*

However, the inherent powers are not limitless. In *Ram Chand and Sons Sugar Mills v. Kanhayalal*, the Supreme Court held that the Court would not exercise its inherent power under section 151 of the CPC if it was inconsistent with the powers expressly or impliedly conferred by other provisions of the Code. Thus, the adjudicating authority cannot override the substantive provisions of the Code or be inconsistent with the express rights or entitlements under the Code while exercising its inherent powers.

The above analysis shows that the adjudicating authority cannot direct the liquidator to liquidate the assets of the guarantor of the corporate debtor. In the instant case, the creditors under the liquidation proceedings and the creditors under the guarantee contract were one and the same; therefore, the act of putting the guarantor's assets in the liquidation pool will only be a matter of convenience for the creditors. Therefore, NCLT's order in the case should be seen as peculiar to the facts and circumstances of the case and shall not be taken as a precedent.