SIMULTANEOUS CLAIM BY A BENEFICIARY OF GUARANTEE

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Editor's Note: *Needless to say that guarantee contracts are highly prevalent in the commercial world and "Liability of a guarantor is co-extensive to that of the surety" is a well-established principle and is the essence of all guarantee contracts. It implies that the creditor has the right to claim its dues from the guarantor prior to the principal debtor/ surety also. It is not necessary that liability of the guarantor shall ONLY arise when the surety makes to fail payment. However, in a scenario where both the surety and guarantor fail to make payment to the creditor, does the creditor have the right to file a claim against both the parties for the same claim in question? Will such simultaneous claim tantamount to dual recovery by the creditor? The following article answers these and several other question in this regard.*

Introduction

In a recent case of *Dr. Vishnu Kumar Agarwal v. M/s. Piramal Enterprises Ltd.Company Appeal (AT) nsolvency) No. 346 of 2018,* the NCLAT has held that an application for initiation of corporate nsolvency resolution process for same very claim/debt is not permissible. Now, consider a situation where Company A (guarantor) has guaranteed the loans given to Company B (principal debtor). When Company B defaulted in payment, the creditor issued a notice to Company A invoking the corporate guarantee, however, even Company A failed to make the payment. If Company A and Company B both are undergoing insolvency proceedings (whether corporate insolvency resolution process or liquidation), can the creditor who has already filed its claim for the entire debt due with the IRP/ Liquidator of Company A, also file its claim with the IRP/ Liquidator of the Company B for the entire debt due?

Dr. Vishnu Kumar Agarwal v. M/s. Piramal Enterprises Ltd.

"an application for initiation of corporate insolvency resolution process for same very claim/debt is not permissible"

Section 5 (8) of the Insolvency and Bankruptcy Code, provides for the definition of financial debt. The relevant extract is reproduced below:

"Financial debt" means a debt along with interest, if any, which is disbursed against the consideration for the time value of money and includes–

*money borrowed against the payment of interest; ***

*** (i) the amount of any liability in respect of any of the guarantee or indemnity for any of the items referred to in sub-clause (a) to (h) of this clause."*

Accordingly, it is clear that the liability w.r.t. guarantee given by a corporate guarantor is a financial debt, however, the moot question that arises for consideration is that whether having filed a claim with the principal debtor, the creditor can file its claim for the entire amount with the corporate guarantor; below the author tries to answer the same.

Discussions on Provisions Of Law:

Section 128 of the Indian Contract Act, 1872 stipulates- "*The liability of the surety is co-extensive with that of the principal debtor, unless it is otherwise provided by the contract*."

It is thus, well settled that the creditor can directly approach the guarantor, without having exhausted its remedies against the principal debtor, but to analyse whether in insolvency cases, the creditor can file dual claims- one against the guarantor and the other against the principal debtor, it is pertinent to cite the following cases:

In *Bank of Bihar v. Damodar Prasad and Anr. 1969 AIR 297, 1969 SCR (1) 620*, the Hon'ble Supreme Court held:

> 3. *The demand for payment of the liability of the principal debtor was the only condition for the enforcement of the bond. That condition was fulfilled. Neither the principal debtor nor the surety discharged the admitted liability of the principal debtor in spite of demands. Under Section 128 of the Indian Contract Act, save as provided in the contract, the liability of the surety is coextensive with that of the principal debtor. The surety became thus liable to pay the entire amount. His liability was immediate. It was not deferred until the creditor exhausted his remedies against the principal debtor.*
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> 4. *Before payment the surety has no right to dictate terms to the creditor and ask him to pursue his remedies against the principal in the first instance. As Lord Eldon observed in Wright v. Simpson "But the surety is a guarantee; and it is his business to see whether the principal pays, and not that of the creditor". In the absence of some special equity the surety has no right to restrain an action against him by the creditor on the ground that the principal is solvent or that the creditor may have relief against the principal in some other proceedings.*
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> 5. *Likewise where the creditor has obtained a decree against the surety and the principal, the surety has no right to restrain execution against him until the creditor has exhausted his remedies against the principal. In Lachhman Joharimal v. Bapu Khandu and Surety Tukaram Khandoji the Judge of the Court of Small Causes, Ahmednagar, solicited the opinion of the Bombay High Court on the subject of the liability of sureties. The creditors having obtained decrees in two suits in the Court of Small Causes against the principals and sureties presented applications for the imprisonment of the sureties before levying execution against the principals. The Judge stated that the practice of his court had been to restrain a judgment-creditor from recovering from a surety until he had exhausted his remedy against the principal but in his view the surety should be liable to imprisonment while the principal was at large. Couch, C.J., and Melvill, J. agreed with this opinion and observed-*
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> *This court is of opinion that a creditor is not bound to exhaust his remedy against the principal debtor before suing the surety and that when a decree is obtained against a surety, it may be enforced in the same manner as a decree for any other debt."*

Again, in *State Bank of India v. Indexport Registered and Ors*.1992 AIR 1740, 1992 SCR (2)1031, it was held that:

> *"13. In the present case before us the decree does not postpone the execution. The decree is simultaneous and it is jointly and severally against all the defendants including the guarantor. It is the right of the decree-holder to proceed with it in a way he likes. Section 128 of the Indian Contract Act itself provides that "the liability of the surety is co-extensive with that of the principal debtor, unless it is otherwise provided by the contract".*

In the case of *Dr. Vishnu Kumar Agarwal v. M/s. Piramal Enterprises Ltd*., the NCLAT has also relied on the aforementioned judgments.

Other Relevant Judgments:

In *Jagannath Ganeshram Agarwala v. Shivnarayan Bhagirath and Ors.*[35], a Division Bench of the Bombay High Court held that the liability of the surety is co-extensive, but is not in the alternative. Both the principal debtor and the surety are liable at the same time to the creditors.

In *Mukesh Hans & Anr. V. Smt. Uma Bhasin & Ors*., the Delhi High Court had observed "*the guarantee is an independent contract and in all fairness, has to be honoured to fulfil the contractual obligation between the surety and the creditor*".

UK Insolvency Act, 1986

The rule against double proof was discussed in detail in the case of *Kaupthing Singer and Friedlander Limited (in administration)[2011] UKSC 48*, wherein the Supreme Court observed as follows:

> *"11. The function of the rule is not to prevent a double proof of the same debt against two separate estates (that is what insolvency practitioners call "double dip"). The rule prevents a double proof of what is in substance the same debt being made against the same estate, leading to the payment of a double dividend out of one estate. It is for that reason sometimes called the rule against double dividend. In the simplest case of suretyship (where the surety has neither given nor been provided with security, and has an unlimited liability) there is a triangle of rights and liabilities between the principal debtor (PD), the surety (S) and the creditor (C). PD has the primary obligation to C and a secondary obligation to indemnify S if and so far as S discharges PD's liability, but if PD is insolvent S may not enforce that right in competition with C. S has an obligation to C to answer for PD's liability, and the secondary right of obtaining an indemnity from PD. C can (after due notice) proceed against either or both of PD and S. If both PD and S are in insolvent liquidation, C can prove against each for 100p in the pound but may not recover more than 100p in the pound in all."*

Replying on the aforementioned ruling, Fletcher in his famous treatise *The Law of Insolvency*[36] has mentioned-

> *"Where the creditor to whom the liability is owed has already roved in the insolvency of the principal debtor, the surety's own liability is thereafter reduced to the amount for which the*

[35] AIR [1940] Bombay 247
[36] Para 23-003, page 728 of The Law of Insolvency, Fifth Edition 2017

creditor's proof has been admitted, less the value of any dividends that has been paid to him."

Conclusion:

The issue under consideration is whether a creditor can simultaneously claim its entire amount of due from the principal borrower as well as from the corporate guarantor, and considering the afore-mentioned, it is clear that the liability of the guarantor and the principal borrower is joint and several. Generally, guarantee deeds also have a clause to the effect that the guarantor is liable in the same manner as if the guarantor is the principal debtor. Under such circumstances, if there is default by the principal debtor, it cannot be that the claim of the creditor against the guarantor can be for any amount lesser than the amount due from the principal debtor. Accordingly, the creditor can claim its dues from the principal borrower and/or the corporate guarantor.
