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Personal Guarantors Liable for Corporate Debt

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Why in News

The **Supreme Court of India** has upheld the **Central Government 2019 notification** that allows lenders to **initiate insolvency proceedings against personal guarantors**.

- It will allow the lenders to recover their remaining debt from personal guarantors following the conclusion of the **Corporate Insolvency Resolution Process (CIRP)**.
- The CIRP is a recovery mechanism made available to creditors as under the Insolvency and Bankruptcy Code, 2016 (IBC).

Key Points

- **Background:**
 - **Definition:** A personal guarantor is a person or an entity that promises payment of another person's debt, in case the latter fails to pay it off.
 - **Central Government Notification 2019:** It brought personal guarantors to companies facing insolvency proceedings under the purview of the Insolvency and Bankruptcy Code (IBC).
 - **Section 1(3)** of the IBC code allows the central government to notify different provisions of the code at different dates, to allow its implementation bit by bit.
 - These rules and regulations lay down the process for **initiating insolvency resolution and bankruptcy proceedings** against personal guarantors to corporate debtors, inviting claims from creditors, withdrawal of such applications, etc.
 - **Simultaneously Proceedings:** The new rules and regulations will allow creditors to simultaneously proceed against the principal borrower, i.e. the company, and the personal guarantor before the National Company Law Tribunal (NCLT).
Until now, the IBC code only covered insolvency resolution and liquidation of corporate debtors.
 - **Counter Argument:** The Central Government did not have the power to bring in IBC provisions selectively to personal guarantors of corporate debtors.
The singling out of guarantors is **violative of the fundamental right to equality**.
- **Supreme Court Verdict:**
 - **Intrinsic Connection:** There was an "intrinsic connection" between personal guarantors and their corporate debtors.
Section 60(2) of the IBC Code had required the bankruptcy proceedings of corporate debtors and their personal guarantors to be held before a **common forum, the NCLT**.
 - **Adjudicating Authority:** The adjudicating authority for personal guarantors will be the NCLT if a parallel resolution process is pending in respect of a corporate debtor for whom the guarantee is given.
The side by side bankruptcy proceedings before the same forum for both the corporate debtors and their personal guarantors **would help the NCLT consider the whole picture**.
- **Concept of Guarantee:** The concept of 'guarantee' is derived from **Section 126** of the **Indian Contracts Act, 1872**.
 - A contract of guarantee is made among the debtor, creditor and the guarantor.
 - If the debtor fails to repay the debt to the creditor, the burden falls on the guarantor to pay the amount.
 - The creditor reserves the right to begin insolvency proceedings against the personal guarantor if the latter does not pay.

- **Possible Benefits:**

- By initiating the insolvency proceedings against personal guarantors, there is a greater likelihood that they would “arrange” for the payment of the debt to the creditor bank in order to obtain a quick discharge.
- The creditor bank would be prepared to take a haircut or forego the interest amounts so as to enable an equitable settlement of the corporate debt, as well as that of the personal guarantor.
- It would result in **maximising the value of assets and promoting entrepreneurship.**

Note

- **Insolvency:** It is a situation where individuals or companies are unable to repay their outstanding debt.
- **Bankruptcy:** It is a situation whereby a court of competent jurisdiction has declared a person or other entity insolvent, having passed appropriate orders to resolve it and protect the rights of the creditors. It is a legal declaration of one’s inability to pay off debts.

Source: TH