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INSOLVENCY OF INDIVIDUAL CORPORATE GUARANTOR: A DISTANT DREAM TO REACH

Abstract

In order to execute the insolvency of individual corporate guarantors, the Ministry of Corporate Affairs notified and brought into force the laws of insolvency of personal guarantors of corporate debtors vide notification dated November 15, 2019. This move has had huge repercussions on the status of individual corporate guarantors. On the one hand, it has brought a wave of joy to creditors and on the other hand, it has opened up an ocean of insecurity for promoters, directors and individuals etc., who fall into this category. The author's objective in this study is to examine the procedural flaws in the Insolvency Code handling of procedures against individual corporate guarantors. In addition, he has come out with tentative recommendations in such a case.

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INTRODUCTION

A country's economy is supported by its banks and financial institutions. The performance of the bank is determined by the performance of the borrowers. If borrowers work harder, they will be in a better position to repay the bank on time and the bank's performance will automatically improve. However, when over 90 borrowers cease paying their loans and interest, the assets become non-performing assets (NPA) for the bank. Between 2008 and 2013, Public sector banks' gross NPA in the year 2008 was 396 billion rupees which increased to 1,558.9 billion rupees till the end of year 2013. The same trend can be seen with private sector banks. Total NPAs rupees of all banks was rupees 556.95 billion which increased to 1,838.5 billion till the end of the year 2013 which was more than three times the gross NPAs of the year 2008. This was an alarming stage for the Government to pay immediate attention on the volume of NPA that was increasing at an alarming rate (Table 1).

TABLE 1:
BANK GROUP-WISE CLASSIFICATION OF LOAN ASSETS OF SCBS-2008 TO 2013

(Rs in.Billion)

Bank Name	Year	Standard Advances	%age Share	Sub-Standard Advances	%age Share	Doubtful Advances	Percent Share	Loss Advances	Percent Share	Gross NPAs	Percent Share	Total Gross Advances
	As on March 31											
Public Sector Banks	2008	16,564.51	97.67	168.46	0.99	190.83	1.13	36.72	0.22	396.00	2.33	16,960.51
	2013	38,999.85	96.16	765.89	1.89	734.85	1.81	58.15	0.14	1,558.90	3.84	40,558.74

Private Sector Banks	2008	4,597.22	97.25	72.81	1.54	44.53	0.94	12.44	0.26	129.78	2.75	4,727.00
	2013	10,266.73	98.09	58.54	0.56	110.69	1.06	30.69	0.29	199.92	1.91	10,466.65
All Banks	2008	22,760.54	97.61	260.89	1.12	243.04	1.04	53.02	0.23	556.95	2.39	23,317.50
	2013	51,872.97	96.58	853.25	1.59	873.05	1.63	112.24	0.21	1,838.54	3.42	53,711.51

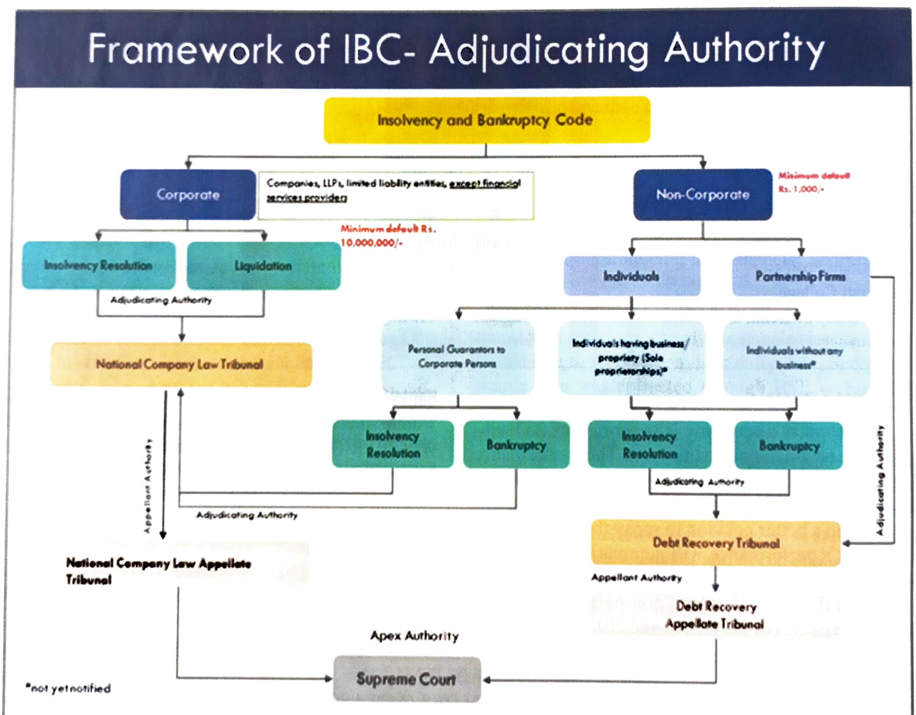
Source: Department of Banking Supervision, RBI, 2021

As a result, the Central Government setup a committee named Bankruptcy Laws Reform Committee (BLRC) in 2014 chaired by Mr. T.L.Viswanathan, former Union Law Secretary to come up with ideas on how to replace the existing law and what that replacement should be. The Committee proposed the Insolvency and Bankruptcy Code, applicable to both corporate and non-corporate sector.

Insolvency and Bankruptcy Code draft was submitted in 2015 and the same was enacted as an Act in 2016. Chapter III of the Insolvency and Bankruptcy Code was recently notified by the Ministry of Corporate Affairs on December 1, 2021- insolvency proceeding against personal guarantor with concerned rules and regulations. The revised structure of the Insolvency and Bankruptcy Code 2016 is clearly depicted in the following Figure 1

FIGURE 1

FRAMEWORK OF INSOLVENCY AND BANKRUPTCY CODE[1]



According to the above figure Insolvency and Bankruptcy Code 2016 has notified the provisions relating to insolvency of corporate sector and under non-cooperate sector the insolvency proceeding against personal corporate guarantors. It is a welcome step at the end of MCA to safeguard the interests of the creditors and to maximize the value to the creditor.

[1]Vinod Kothari and Company. (2021). *Personal Guarantor under IBC 2019 New.* Retrieved from www.ICSI.edu: https://www.icsi.edu/media/filer_public/bf/f0/bff01d60-8d17-4a99-8513-777afd2848c2/personal_insolvency_and_bankruptcy_2019_new.pdf

WHY PRINCIPAL GUARANTOR

Under section 126 of the Indian Contract Act 1872, *"A contact of guarantee is a contract to perform the promise, or discharge the liability of a third person in case of this default"*.

Therefore, it is a contract between the surety and creditor where the surety is also liable to the creditor. Moreover, section 128 of the Indian Contract Act talks about the co-extensive liability of surety which means the surety becomes liable to make payment immediately on default of principal debtor. Hence according the Indian Contract Act, it is the responsibility of the surety to make good of loss to creditors. This is the obvious reason why personal guarantee is required when applying for a corporate loan from any bank or financial institution. This principle not only protects creditors' interests, but it also places greater responsibility and accountability on the shoulders of the personal guarantor. The view was supported by the decision of the apex court Bench of Justice L.N. Rao and Justice S.R. Bhat. In their eighty two pages judgment Justice Bhat mentioned this relationship as an "intimate" relationship and the position of guarantor as "separate species"[2]. He also said.

Approval of a resolution plan does not ipso facto discharge a personal guarantor (of a corporate debtor) of her or his liability under the contract of guarantee. As held by this court, the release of discharge of principal borrower from the debt owed by it to its creditors, by an involuntary process, i.e. by the operation of law, or due to liquidation and insolvency proceeding, does not absolve the surety/ guarantor of his or her liability, which arise out of an independent contract"[3].

PROCEDURAL SHORTCOMINGS

Initiating Insolvency Proceedings Against Personal Corporate Guarantor Under IBC

Setting a procedure is altogether different from observing the procedure. The challenges of procedure can only be visualized experienced when it is actually followed. The Working Group[4] (Insolvency and Bankruptcy Board of India, 2017) chaired by Mr. P.K. Malhotra suggested a common forum for proceeding against both debtor and guarantor with a view to introduce other measures to coordinate parallel proceedings. Does it actually happen? It is still doubtful what steps have been introduced by the IBC or IBBI to coordinate the parallel proceedings.

As per report, K.R. Srivats challenged the legal validity of the Insolvency And Bankruptcy Code provision mentioning the expert views of Mr. Aditya Nayyar, Partner Ortis Law Office, stating that on default of the debtor the guarantor himself becomes a creditor and parallel proceeding against creditor would be wholly unconstitutional[5].

Looking at the cases of *Shiva Industries, Jet Airways,* and *Videocon* etc. one can easily understand how banks are playing with the rules and regulation. In the name of one-time settlement option, they are allowing above 90 per cent haircut on the cost of public saving.

Ms. Sucheta, has challenged the intention of the Government and the objectivity of IBC by saying : *"If the government is serious about making defaulters pay and retain the faith of taxpayers, it needs to change the resolution process which is already ridden with corruption"*[6].

All India Bank Employees' Association's General Secretary B. S. Rambabu said that, *"The heavy haircut decision by BJP-led NDA government in tune with the 'Insolvency and Bankruptcy Code-16' is making profit-making bank sick"*[7]

All difficulties discussed are based on legal doubts, misuse of Code, human corruption and favoritism, contradictory laws, and judgments. In addition to the aforementioned legal and other flaws, the author would like to point out a few procedural flaws that lead us to assume that corporate guarantor insolvency is a distant dream

1. **Guarantor's Personal Assets Tracing:** There is no provision in any law to maintain a record of guarantor's assets either at the end of principal debtor or the creditor. The change in assets position is obvious from the time the loan was granted and the time the loan was defaulted. In today's time when transfer and movement of assets are very easy and very fast, the gravity of challenge increases many fold. Millions of rupees can be transferred to any part of the globe on a single click. Locating assets in the world and in various judicial systems is challenging and securing a recovery claim on such assets is even more complex. Until or unless we are able to find out the solution for the said problem, insolvency of corporate guarantor is like a day dreaming.
2. **Unrealistic timelines**: IBC is socially appreciated for its time bound action. In the absence of any ready to use information, any experts' assistance, any support of law to access personal information and non-cooperation by guarantor concluding the proceeding of insolvency in 180 days is like a dream and far from reality.
3. **Non-cooperative attitude of Guarantor**: Expecting

[2] Rajagopal, K. (2021, May 22). Supreme Court stated that personal guarantors are liable for corporate debt. *The Hindu* .

[3] Mahapatra, d. (2021, May 22). Guarantors for loans liable under IBC proceedings: SC. *Times of India*

[4] Insolvency and Bankruptcy Board of India has constituted a Working Group for recommending the strategy and approach for implementation of provisions regarding gaurantors of corporate debtors and individuals.

[5] K.R.Srivats. (2020, September 24). Personal Guarantors: IBBI, Govt to defend legal validity of IBC provisions. *The Hindu* .

[6] Dalal, S. (2021, June 30). *Stop the Loot via Bankruptcy Code: Better Solutions Are Possible.* Retrieved from moneylife: moneylife.in/article/stop-the-loot-via-bankruptcy-code-better-solutions-are-possible/64378.html

[7] Patnaik, S. (2018, November 1). 'Heavy haircut' decision making PSU banks sick, says AIBEA. *The Hindu* .

cooperative behavior from a guarantor throughout the insolvency process is unusual. Furthermore, the Insolvency and Bankruptcy Code is silent on the consequences of a personal guarantor's refusal to participate. Similarly, the Tribunal has not yet enlisted any such procedures to deal with a scenario like this.

4. **Just and Equitable Plan:** The Insolvency and Bankruptcy Code paid no attention to the significance of the just and equitable plan test. In this regard the Code does not contain any provision. The repayment plan does not have to be tested for fairness, equity, or justice to all of the guarantor's creditors.

5. **Role of ED in IBC:** Recently according to mint report by Sneha (published by HT media) Rs. 9371.17 Crore worth assets were seized and transferred to public sector banks that suffered losses due to frauds committed by businessman Vijya Malya, Mehul Choksi and Nirav Modi. The total assets attached were worth Rs. 18,170.02 crores. The most popular means of channeling money (assets) to save it from moratorium is now to deposit it in an International Bank. This statement is supported by the most recent news by ET Prime about Finance Ministry:

> *"India has sought information from Swiss authorities on deposits by its citizens in Swiss banks. Deposits by Indian Swiss banks rising to Rs 20,700 crore at the end of 2020, from Rs 6,625 crore at the end of 2019. The Swiss Authorities have been requested to provide the relevant facts along with their view on possible reasons for increase/decrease"*[*]

The involvement of the ED not only restrains cross-border asset movement but will also help in bringing defaulters back to India and recovering assets from them.

6. **Mushroom growth of Assets Tracing Agencies:** Assets tracing is not an easy task. Multi specialized persons should work together to trace the assets. Specialized knowledge required may include:
   - Lawyers
   - Accountants
   - Data analysts
   - Auditors
   - Economists
   - Computer forensic practitioners
   - Corporate investigators
   - Anti-money laundering specialists
   - Certified fraud examiners

An IRP/RP cannot undertake all specialized work on his or her own. In such a circumstance, Asset Tracing Agencies (ATA) will be able to expand their demand among IPs and, as a result, the market allows such agencies to grow tremendously. This will increase not only the expense of insolvency, but also the reliance on third-party without accountability.

SUGGESTIONS

1. The IBC should use realistic and flexible timelines.
2. There should be a utility centre that keeps track of all personal guarantors' assets and updates it on a regular basis.
3. The IB Code should include mechanisms to deal with situations when the guarantor refuses to cooperate.
4. Repayment plan should be judged on its fairness and on a foundation that is just and equitable.
5. The IB Code should be revised so that there is no conflict between the contract Act and the code when it comes to guarantor's rights, such as the right of subrogation.
6. NCLT's contradictory decisions should be carefully scrutinised by the Supreme Court to avoid any uncertainty among IPs.
7. IBC, ED and Government agencies work together to restrict the individual corporate guarantor to mobilize their assets cross boarder

> **Incorporating a chronology into the judiciary system is difficult, especially when the procedure is entirely reliant on the information, knowledge and cooperation of someone**

CONCLUSION

It is suggested that, the existing IBC provisions are just a framework of initiating insolvency proceeding against individual corporate guarantors. Government should bestow its immediate and urgent attention on the identification of loopholes in the Code and take all necessary steps to overcome the practical shortcomings faced by IPs in handling such proceedings.

Incorporating a chronology into the judiciary system is difficult, especially when the procedure is entirely reliant on the information, knowledge and cooperation of someone who is unsure of what is going on against him. Other sources that can supply information to speed up and streamline the procedure are not recognised by the Code or any other Government entity.

Finally, in an era of globalisation where cross-border insolvency may be a reality, our IB Code has not specified a mechanism for dealing with cross-border insolvency and the Code is limiting itself to dealing with cross-border insolvency. MA

[*] Aulakh, G. (2021, June 20). Swiss authorities asked to provide info on deposits by Indians in Swiss banks: Fin Min. *ETPrime*.

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