

# Approval of resolution plan does not discharge personal guarantor of liabilities under the contract of guarantee

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**This update covers:**

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1	Background _____	1
2	Supreme Court's Decision _____	2
2.1	Selective enforcement of the Code to personal guarantors _____	2
2.2	Appropriate forum for insolvency resolution of personal guarantors _____	2
2.3	Liability of a personal guarantor on approval of resolution plan _____	2
3	Conclusion _____	3

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## 1 Background

A two-judge bench of the Supreme Court in *Lalit Kumar Jain v Union of India & Ors.* upheld the validity of a notification dated 15 November 2019 (**2019 Notification**) which allowed creditors to initiate an insolvency resolution process against personal guarantors of corporate debtors (i.e. companies undergoing insolvencies) before National Company Law Tribunal (**NCLT**). Prior to the issuance of the 2019 Notification, it was not possible for creditors to initiate insolvency resolution process against individuals including personal guarantors.

The petitioners before the Supreme Court had provided personal guarantees for borrowings by companies which were owned/promoted by them. The borrower companies were unable to honor their financial commitments. Consequently, the lenders initiated an insolvency resolution process against the companies under the Insolvency and Bankruptcy Code 2016 (**Code**). The lenders were unable to recover their full dues from the sale or dissolution of the borrower companies and subsequently they invoked insolvency resolution process against the petitioners pursuant to the 2019 Notification. In response, the petitioners challenged the 2019 Notification before various High Courts across the country. However, the Supreme Court passed directions to

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The Supreme Court has held that release or discharge of a principal borrower from the debt owed by it to its creditor by an involuntary process, i.e. by operation of law, or due to liquidation or insolvency proceeding, does not absolve the surety/guarantor of his or her liability, which arises out of an independent contract.

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transfer all such petitions from the various High Courts to itself and decided the issues raised by the petitioners through this judgement.

## **2 Supreme Court's Decision**

### **2.1 Selective enforcement of the Code to personal guarantors**

The petitioners contended that the Government had selectively brought into force the insolvency regime for personal guarantors of corporate debtors, as the insolvency regime in respect of individuals (i.e. individuals who are not personal guarantors to corporate debtor) and partnership firms have not been brought in force. The basis for this argument was that Part III of the Code applies equally to all individuals and partnership firms and it is not possible to carve out a limited application of the provisions/Part III of the Code only in relation to personal guarantors to corporate debtors.

The Court observed that the provisions of the Code were planned to be implemented in stages to fulfill the objectives of the Code. Consequently, personal guarantors may be viewed as a distinct class of individuals and there is a valid basis for treating them differently than individuals who have not provided personal guarantees.

### **2.2 Appropriate forum for insolvency resolution of personal guarantors**

Part III of the Code provides that the Debt Recovery Tribunal (DRT) shall be the adjudicating authority for insolvency resolution of individuals. However, the 2019 Notification provided that the NCLT shall be the adjudicating authority for insolvency resolution of individuals who have provided personal guarantees. The petitioners argued that the 2019 Notification is not in accordance with the Code as the Code does not contemplate NCLT as the adjudicating authority for insolvency resolution of individuals. Further, the petitioners argued that designating a different forum (i.e. NCLT) for individuals who have provided personal guarantees amounts to unequal treatment of equals. The petitioners therefore contended that the DRT should be treated as an adjudicating authority in respect of insolvency resolution of personal guarantors.

The Apex Court held that while the insolvency process for corporate debtors and personal guarantors are different processes, bringing them before the same forum (i.e. the NCLT) would enable the NCLT and committee of creditors in framing realistic plans taking into account assets and liabilities of the corporate debtor and the personal guarantor.

### **2.3 Liability of a personal guarantor on approval of resolution plan**

The petitioners asserted that the liability of a personal guarantor is co-extensive with that of the corporate debtor and therefore liability of a guarantor would be extinguished on approval of the resolution plan of the corporate debtor. For this purpose, various provisions of the Indian Contract Act, 1872 dealing with discharge of liability of a guarantor upon discharge of liability of the borrower or in case of settlement between borrower and creditors were cited by the petitioners.

The Court held that the release or discharge of a principal borrower from the debt owed by it to its creditor by an involuntary process, i.e. by operation of law, or due to liquidation or insolvency proceedings, does not absolve the surety/guarantor of his or her liability, which arises out of an independent contract. Accordingly, a personal guarantor would not be discharged by virtue of a resolution plan of a corporate debtor being approved under the Code. In other words, a personal guarantor would continue to be liable for the balance amount even after approval of a resolution plan of the borrower.

### **3 Conclusion**

The judgment provides much needed clarity on initiation/continuance of insolvency resolution process against personal guarantors. It also provides clarity that the release or discharge of a principal borrower from the debt owed by it to its creditor due to liquidation or insolvency proceeding does not absolve the guarantor of his or her liabilities.

The judgement is likely to pave the way for minimising losses faced by banks/financial institutions from large borrower accounts where the insolvency resolution process of the borrower did not result in a meaningful recovery. In such cases, depending upon the availability of personal guarantees, lenders may initiate insolvency resolution process against personal guarantors.

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