

Insolvency and Bankruptcy Hotline

November 12, 2018

UNINVOKED/UNMATURED CLAIMS CAN BE TREATED AS VALID DEBT UNDER INSOLVENCY CODE

- A claim submitted by a creditor during the insolvency resolution process can be disputed, undisputed, matured or unmatured
- An uninvoked guarantee although an unmatured claim can be included in the total liabilities of the corporate debtor
- There is no nexus between submission of a claim and default of a debt
- Quantum of a claim should be as on the insolvency commencement date

INTRODUCTION:

The National Company Law Tribunal, Principal Bench ("**NCLT**") in the matter of *Axis Bank Limited v Edu Smart Services Private Limited*, had rejected a plea from Axis Bank in respect of its claim under a corporate guarantee in the insolvency resolution process of Edu Smart Services Private Limited ("**Edu Smart**"). Axis Bank had invoked its claim around two weeks after the initiation of the resolution process but the NCLT held that the corporate guarantee could not be treated as a debt since it had not been invoked before the commencement of the process for insolvency resolution. This decision was challenged before the Appellate Authority ("**NCLAT**") by Axis Bank which overturned the decision of the NCLT, thereby upholding Axis Bank's claim. We have in the below sections discussed the order passed by the NCLAT and the ramifications of the same.

FACTS:

Axis Bank had filed its claim in the insolvency process of Edu Smart, which was rejected by the Resolution Professional ("**RP**"). Thereafter, Axis Bank had filed an application under Section 60(5) of the Insolvency and Bankruptcy Code ("**Code**") before the NCLT challenging the decision of the RP. However, the NCLT rejected the application of Axis Bank on the ground that (a) the 'corporate guarantee' had not been invoked prior to the initiation of the corporate insolvency resolution process and hence the liability under the guarantee had not crystallized/matured as on the insolvency commencement date, i.e. date on which the application seeking initiation of the insolvency process had been admitted; (b) under the Code only those claims should be considered which are due and payable as on the insolvency commencement date; (c) a right to claim any debt only arises when the Creditor's debt is due and payable, in case of a guarantee the debt becomes due only when a creditor invokes a guarantee and (d) after the order of admission a moratorium is in effect which will bar any action to foreclose, recover or enforce any security interest created by the corporate debtor, which will bar invocation of a guarantee as well.

ISSUE:

Whether a corporate guarantee must have been invoked prior to the initiation of insolvency proceedings for the guarantee holder to be granted the status of a '*Financial Creditor*'?

JUDGMENT:

The NCLAT scrutinized the corporate guarantee and stated that per the provisions of the guarantee, in the event of any default on the part of the principal borrower, the guarantor shall, upon demand, pay without demur all the amounts payable by the 'principal borrower'. As per Clause 21 of the terms of guarantee, the guarantee shall be a continuing one and shall remain in full force and effect till the time the principal borrower repays in full the loans together with all interest, liquidated damages, costs, charges and all other monies payable. Therefore, NCLAT observed that Axis Bank could be considered as a lender to the guarantor and that Axis Bank could treat the guarantor as the principal debtor.

NCLAT also weighed the definitions of debt, default and claim to conclude that (a) a debt is the liability or obligation in respect of a claim which is due from any person and a default of debt occurs when there is non-payment of any part of the debt (b) a claim is independent of an actual default of the debt, which may exist irrespective of the occurrence of a default; and (c) a claim can be (i) a right to payment whether disputed, undisputed, secured or unsecured or (ii) a right to payment arising from a breach of contract irrespective of whether the same is matured, unmatured, disputed or undisputed.

Thereafter, the NCLAT addressed the question of whether the term 'claim' which is independent of debt and default would only include a "matured claim". The NCLAT observed that on the declaration of moratorium the RP has to issue a public announcement under Section 13 read with Section 15, inviting all creditors to submit their claims. Thereafter, the RP under section 18 would collate all the claims received from the creditors. However, the only stipulation with respect to the '*claims*' is that the same has to be computed as on the insolvency commencement date. The right of the creditor to file a claim would be as per the definition of claim which includes matured, unmatured, disputed and undisputed claims. The RP would not need to examine as to whether there has been a default in respect of the claim being made by the creditor.

The NCLAT also observed that as per Section 25(2)(e) of the Code, the RP is supposed to maintain an updated list of

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claims submitted by the creditors. This fact also suggests that maturity of a claim or default of debt are not the guiding factors to be noticed for admission of claims.

Finally, the NCLAT on a reading of the various provisions of the Code and the definition of 'claim' concluded that maturity of a claim or default in pursuance of a claim or invocation of guarantee for claiming the guaranteed amount has no nexus with filing of a claim pursuant to a public announcement by the RP. The only consideration would be to ascertain the quantum of claim as on the insolvency commencement date.

ANALYSIS:

Prior to this decision, the issue of maintainability of a claim, on the basis of a corporate guarantee issued by a corporate debtor, undergoing Corporate Insolvency Resolution Process which was not invoked on the insolvency commencement date, was largely unresolved. However, with the NCLAT's recent decision, the issue has been put to rest as of now. This judgment will help resolve some otherwise complicated situations.

SITUATION 1

Company A is the principal borrower which has received financial assistance from Creditor C which has been guaranteed by Guarantor B. There has been no default committed by A and hence C cannot contractually invoke the guarantee of B. Subsequently, insolvency proceedings have been initiated against B and the RP is collating total claims of all the creditors of B. C has yet not invoked the guarantee of B because A has not committed any default. However, if C is not allowed to add its claims under the guarantee in the insolvency process of B and there are defaults committed by A in the future then C will be remediless in terms of the guarantee provided by B, because B could have been liquidated by then.

SITUATION 2

Company A has issued certain redeemable instruments in favour of Creditor B in lieu of certain investments which have a maturity date. As per the overturned stand of the NCLT, under the Code only those claims could be considered which are due and payable as on the insolvency commencement date and a right to claim any debt only arises when the Creditor's debt has matured or is due and payable. If on the insolvency commencement date the maturity date has not expired, then B will not be able to make a claim in respect of such redeemable instruments as the amount is not due and payable on the insolvency commencement date.

The ability to initiate insolvency process is based on the existence of debt and default therein, because without the element of default a corporate entity cannot be entitled as insolvent. However, if the process has been initiated then the creditors have no option but to participate in the same. At that juncture to disallow a creditor to participate in the process on the basis of the maturity/invocation of its dues would be unfair and inequitable. The initiation of insolvency proceedings would be the action deeming maturity of a debt, however due to the onset of moratorium creditors are being disallowed to enforce their contracts post the insolvency commencement date. The order of the NCLAT will help resolve these situations and help creditors in realising their dues irrespective of whether the same have matured as on the insolvency commencement date.

– Arjun Gupta & Simone Reis

You can direct your queries or comments to the authors

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