

Fair
Wisdom.
Just Advice



FAIR & JUST
— LEGAL SOLUTIONS LLP —

IBC: APPLICABILITY OF THE MORATORIUM TO PERSONAL GUARANTOR

Article By: Sharad Tyagi and Yukti Makan

The Insolvency and Bankruptcy Code, 2016 (“**IBC**”) is one of the biggest economic reforms in the Indian history. IBC is designed to deal with the financial sickness of any corporate debtor in a time bound manner by initiating the insolvency resolution process for revival or restructuring of the defaulting corporate debtor in terms of the provisions of IBC.

The insolvency resolution process for revival or restructuring of defaulting corporate debtor can be invoked by any operational creditor or financial creditor by filing an application with the National Company Law Tribunal (“**NCLT**”). If NCLT is satisfied that the application filed by such operational creditor or financial creditor meets the criteria as laid down under IBC, it may accept the application and shall order the appointment of an Interim Resolution Professional (“**IRP**”). Once a petition under IBC is admitted by NCLT against the corporate debtor, a moratorium upto 180 days (as extendable by another 90 days) may be granted by NCLT during which all the recovery proceedings against the corporate debtor shall be stayed by virtue of the provisions of Section 14 of IBC.

One of the contentious issues was whether the benefit of moratorium, as envisaged in Section 14 of IBC, could also be available to the personal guarantor? In this article, we have discussed and analysed the legal provisions and judicial precedents pertaining to the applicability of moratorium on the personal guarantor.

MEANING OF MORATORIUM

The basic purpose of moratorium is to put a stay on the institution or continuation of proceedings, suits, etc. against the corporate debtor and to bar any encumbrances, sale or alienation of its assets.

The moratorium, in terms of IBC, is *inter alia* defined as a period wherein no judicial proceedings for recovery, enforcement of security interest, sale or transfer of assets or termination of essential contracts can be instituted or continued against the corporate debtor.

MEANING AND CONCEPT OF GUARANTEE

Section 126 of the Indian Contract Act, 1872 (“**Act**”) defines a contract of guarantee as “*a contract to perform the promise, or discharge the liability, of a third person in case of his default*” and further states that “*a guarantee may be either oral or written.*”

The person providing the guarantee is known as a ‘guarantor’ or a ‘surety’. As per Section 128 of the Act, the liability of the surety is ‘**co-extensive**’ with that of the principal debtor, unless it is otherwise provided for by the contract of guarantee.

In the case of **State Bank of India vs. Smt. Goutmi Devi Gupta and Ors. (AIR 2002 MP 81)**, the Madhya Pradesh High Court (Jabalpur Bench) on October 15, 2001 has held that “*The surety contracts: “Trust the borrower I undertake to be responsible” or “if he does not pay I will”. This is the basic postulate or essence of the contract of guarantee. A surety in the eye of law is a favoured debtor. Under Section 128 of the Contract Act, save as otherwise provided in the contract, the liability of the surety is co-extensive with that of the principal debtor. The surety thus becomes liable to pay the entire amount. His liability is immediate and simultaneous. It is not deferred until the creditor exhausts his remedies against the principal debtor either personally or against the property mortgaged or hypothecated by him. The creditor gets the right to recover the amount straightaway from the surety. The right of creditor to proceed against the surety is not dependent or contingent upon his remedy being exhausted against the borrower. The creditor cannot be asked to pursue his remedies against the principal debtor either personally or against his mortgaged or hypothecated property in first instance.*”

Hence, it is clear that it is the discretion of the lender to proceed with the recovery either from the borrower or the guarantor. The aforesaid discretion of the lender cannot be challenged by the guarantor or borrower.

MORATORIUM: JUDGMENTS FAVOURING THE PERSONAL GUARANTOR

Judgment dated September 6, 2017 of the Allahabad High Court in the matter of Sanjeev Shriya vs. State Bank of India & Ors. [Writ – C No. – 30285 of 2017]

In this case, the petitioner, Mr. Sanjeev Shriya, was a director of L.M.L. Limited against which the recovery proceedings were pending before the Debt Recovery Tribunal (“**DRT**”), Allahabad Bench. L.M.L. Limited was also facing insolvency resolution proceedings before NCLT, Allahabad, which had declared the moratorium under Section 14 of IBC in relation to L.M.L. Limited. The petitioner had given his personal guarantee to the State Bank of India (“**SBI**”) for availing of a loan by the aforesaid company. The aforesaid company defaulted in payment of SBI’s dues, due to which, legal proceedings were initiated against such company and the petitioner before DRT. The proceedings before DRT was challenged on the ground of moratorium declared by NCLT under Section 14 of IBC.

Keeping in view of the moratorium declared by NCLT, DRT decided to keep the proceedings against L.M.L. Limited in abeyance. However, it continued with the proceedings against the petitioner as guarantor and others. The petitioner challenged the decision of DRT before the Hon’ble Allahabad High Court by filing a writ petition, which stayed the recovery proceedings against the guarantor(s) as initiated by DRT, till finalization of the Corporate Insolvency Resolution Process (“**CIRP**”) or till NCLT approves the resolution plan or passes an order for liquidation of the aforesaid company.

Judgment dated September 18, 2017 of the National Company Law Tribunal, Chennai Bench [CP/510/IB) / CB / 2017] and judgment dated February 28, 2018 of the National Company Law Appellate Tribunal [Company Appeal (AT) (Insolvency) No. 213 of 2017] in the matter of M/s Veasons Energy Systems Private Limited

The promoter and the managing director (“**Guarantor**”) of Veasons Energy Systems Private Limited (“**Corporate Debtor**”) had given personal guarantee against the loan availed by the Corporate Debtor from

SBI. The Corporate Debtor was unable to repay the loan and that led to the initiation of CIRP against the Corporate Debtor. After the declaration of moratorium period and invitation of claims by the resolution professional, SBI filed its claim in the capacity of a financial creditor. Thereafter, SBI issued an auction notice under SARFAESI Act, 2002, to sell the personal property of the Guarantor to recover its dues. The Guarantor approached NCLT which held that moratorium period as stipulated under Section 14 of IBC shall also apply to the Guarantor, thus, SBI is restrained to sell the personal property of the Guarantor.

NCLT, vide its order dated September 18, 2017, held that allowing invocation of the personal guarantee would result in violation of Section 14 (1) (b) of IBC. The invocation of guarantee during moratorium is violative of the basic idea of the resolution process. Also, it relied on Section 31 (1) of IBC, wherein it is stated that once the resolution plan is approved by the committee of creditors and is in accordance with the prerequisites under Section 30 (2) of IBC, the resolution plan shall be binding on the corporate debtor and its employees, members, creditors, **guarantors** and other stakeholders involved in the resolution process. Against the aforesaid order of NCLT, SBI preferred an appeal before the National Company Law Appellate Tribunal (“**NCLAT**”).

NCLAT, vide its order dated February 28, 2018, has also upheld the decision of NCLT, that moratorium granted under Section 14 of IBC would also extend to personal guarantors as well as the corporate debtor.

Further, after the order of NCLAT, the matter went upto the Supreme Court for its consideration. The Supreme Court reversed the order of NCLAT. The relevant text of the aforesaid judgment of the Supreme Court are mentioned below under the heading ‘*Judgments not favouring the Personal Guarantor*’.

Judgment dated January 23, 2018 passed by NCLT Chennai Bench [CP/703/IB/2017, CP/704/IB/2017, CP/705/IB/2017, CP/706/IB/2017, CP/707/IB/2017] and Judgment dated April 18, 2018 passed by the National Company Law Tribunal in the matter of State Bank of India vs. D.S. Rajendra Kumar and Ors. [Company Appeal (AT) (Insolvency) Nos. 87,88,89,90 and 91 of 2018]

In this case, NCLT, had declared the moratorium under Section 14 of IBC in favour of the corporate debtor ‘Brilliant Alloys Private Limited’. SBI being a financial creditor sought the permission of NCLT for initiating the insolvency proceedings against the personal guarantors under Section 60(2) of IBC.

NCLT, vide its order dated January 23, 2018, has held that moratorium shall be available to the personal guarantors till NCLT approves a resolution plan or passes an order for liquidation. Against the aforesaid order of NCLT, SBI preferred an appeal before NCLAT.

NCLAT, vide its order dated April 18, 2018, has also upheld the view of NCLT, that moratorium granted under Section 14 of IBC would also extend to personal guarantors as well as the corporate debtor.

MORATORIUM: JUDGMENTS NOT FAVOURING THE PERSONAL GUARANTOR

Judgment dated July 4, 2017 passed by NCLT Mumbai Bench [T.C.P. No. 1117/I&BP/NCLT/MB/MAH/2017] and judgment dated July 31, 2017 [Company Appeal (AT) (Insolvency) No. 116 of 2017] passed by NCLAT in the matter of Alpha & Omega Diagnostics (India) Ltd. vs. Asset Reconstruction Company of India Ltd. & Ors.

In this case, NCLT, has interpreted Section 14(1)(c) in its literal sense. It was held that the term 'its' refers to the property of the corporate debtor. Therefore, the property not owned by the corporate debtor would not fall under the ambit of moratorium. NCLAT vide its order dated July 31, 2017, has also upheld the decision of NCLT that moratorium would not be applicable to any assets, movable or immovable, that does not belong to the corporate debtor.

Judgment dated July 3, 2018 passed by NCLT Mumbai Bench (T.C.P. No. 1059/I&BP/NCLT/MB/MAH/2017) and Judgment dated August 9, 2017 [Company Appeal (AT) (Insolvency) No. 129 of 2017] passed by NCLAT in the matter of Schweitzer Systemtek India Private Limited vs. Phoenix ARC Private Limited & Ors.

The issue 'whether the personal property of the guarantors that was given as security would fall under the purview of moratorium declared under Section 14 of IBC' was also discussed in the aforesaid matter.

NCLT *inter alia* held that ".....the Moratorium shall prohibit the action against the properties reflected in the Balance Sheet of the Corporate Debtor. The moratorium has no application on the properties beyond the ownership of the Corporate Debtor.....". NCLAT, vide its order dated August 9, 2017, also upheld the decision of NCLT Mumbai Bench.

Judgment dated November 28, 2017 passed by Bombay High Court in the matter of Sicom Investments and Finance Limited vs. Rajesh Kumar Drolia and Anr. [Summons for Judgment No. 221 of 2010]

In this case the Bombay High Court held that no automatic protection is available to the guarantor in favour of the corporate debtor. The relevant text has been reproduced below for ease of reference:

"59. What is absolutely clear from the Code is that for the guarantor (be it personal guarantor or corporate guarantor), there is no automatic protection. It is only once the insolvency resolution has been initiated either by or against the guarantor (be it personal guarantor or a corporate guarantor), only then the benefit of the moratorium would be available to the guarantor subject of-course to the other provisions of the IBC, 2016."

Judgment dated August 14, 2018 passed by the Supreme Court in the matter of State Bank of India vs. V. Ramakrishnan & Anr. [Civil Appeal No. 4553 of 2018]

The Supreme Court in this case has held that "17. Section 14 refers to four matters that may be prohibited once the moratorium comes into effect. In each of the matters referred to, be it institution or continuation

of proceedings, the transferring, encumbering or alienating of assets, action to recover security interest, or recovery of property by an owner which is in possession of the corporate debtor, what is conspicuous by its absence is any mention of the personal guarantor. Indeed, the corporate debtor and the corporate debtor alone is referred to in the said Section.”

IMPORTANT ASPECTS

It is imperative to understand that:

1. The applicability of moratorium has been dealt with separately for the corporate debtor in Section 14 of IBC and for the personal guarantor in Section 101 of IBC.
2. For availing the benefit of moratorium in case of a personal guarantor, separate insolvency resolution proceedings are required to be initiated before the relevant adjudicating authority viz. NCLT in case of corporate persons and DRT in case of individuals / partnership firms. However, in terms of Section 60(2) of IBC, where an insolvency resolution process against a corporate debtor is pending before NCLT, the insolvency resolution or bankruptcy of a personal guarantor of such corporate debtor can only be filed before such NCLT.
3. As far as the benefit of moratorium is concerned vis-à-vis personal guarantor, the same shall be triggered only upon admission of an application of insolvency resolution process against such guarantor in terms of the provisions of Section 94 - 101 of IBC. The inference drawn by some of the experts that the provisions of Section 14 of IBC providing moratorium to the corporate debtor shall also be applicable to the personal guarantor may not be a correct stand keeping in view the independent provisions of Section 94 - 101 of IBC as applicable to the individual debtor / personal guarantor which requires filing of an application by or against the individual debtor / personal guarantor and its admission by DRT under Section 100 or NCLT under Section 60 (2) of IBC.
4. Since the provisions of Part III of IBC comprising of Section 94 - 101 have not yet been notified, moratorium under Section 101 is not an available route currently. However, on notification of Part III, the benefit of moratorium shall be available to the personal guarantor only on separate initiation of insolvency process against it as mentioned above.
5. In case the guarantor defaults in payment of the guaranteed amount, it is the discretion of the lender either to invoke the SARFAESI proceedings or to initiate the insolvency resolution process against such guarantor under Section 95 of IBC. In case, the moratorium has not been declared, the SARFAESI proceedings will continue, if initiated, by the lender.
6. The benefit of moratorium under Section 14 is applicable only and only to the corporate debtor. Hence, the Supreme Court, in the matter of State Bank of India as mentioned above, has rightly distinguished between moratorium under Section 14 and 101 of IBC.