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SUPREME COURT SETTLES THE DEBATE: NO MORATORIUM FOR PERSONAL GUARANTORS UNDER SECTION 14 OF THE INSOLVENCY CODE

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In a significant ruling having widespread ramifications, the Hon'ble Supreme Court (Court) on 14 August 2018 pronounced its judgment in the case of *State of Bank of India v V. Ramakrishnan & Anr* (Civil Appeal No. 3595 of 2018). The Court held that the period of moratorium under Section 14 of the Insolvency and Bankruptcy Code, 2016 (Code) would not apply to the personal guarantors of a corporate debtor.

Factual Background

In February 2014, Mr. V. Ramakrishnan, the Managing Director of M/s. Veasons Energy Systems Private Limited (Veasons) signed a personal guarantee in favour of State Bank of India (SBI) with respect to certain credit facilities availed by Veasons from SBI.

Veasons, however, failed to pay its debts in time, pursuant to which SBI initiated proceedings against Veasons under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) demanding an outstanding amount of about INR 61 crores.

In the meantime, an application was filed by Veasons under Section 10 of the Code for the initiation of voluntary corporate insolvency resolution proceedings (CIRP). This application was admitted, following which a period of moratorium under Section 14 of the Code was imposed.

During the pendency of the CIRP, an interim application was also filed by Mr. Ramakrishnan, wherein it was argued that provisions of Section 14 of the Code would also apply to the personal guarantors of a corporate debtor and therefore, any proceedings against him and his property would have to be stayed.

By an order dated 18 September 2017, the National Company Law Tribunal (NCLT), Chennai Bench allowed the application filed by Mr. Ramakrishnan and restrained SBI from moving against him until the period of moratorium was over.

An appeal was preferred by SBI, against the order of the NCLT, before the National Company Law Appellate Tribunal (NCLAT). The NCLAT delivered its judgment (Impugned Judgment) on 28 February 2018 refusing to interfere with the order passed by the NCLT. In doing so, the NCLAT relied on Section 60 and Section 31 of the Code to hold that the moratorium imposed under Section 14 would also apply to the personal guarantor.

ERGO | SUPREME COURT SETTLES THE DEBATE: NO MORATORIUM FOR PERSONAL GUARANTORS UNDER SECTION 14 OF THE INSOLVENCY CODE

The Impugned Judgment was challenged by SBI before the Hon'ble Supreme Court. Interestingly, even as the appeal filed by SBI remained pending, the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018 (Ordinance) was promulgated on 6 June 2018. By this amendment, amongst other changes, Section 14(3) of the Code was substituted to read that the provisions of Section 14(1) would not apply to a surety in a contract of guarantee to a corporate debtor.

Decision of the Hon'ble Supreme Court

Upon hearing the parties at length, the Court proceeded to decide the issues as follows:

On the interpretation of Section 14 of the Code

- The Court observed that Section 14 did not make any reference to personal guarantors and it was only the corporate debtor, which was referred to therein. In such a scenario, a plain reading of Section 14 would lead to the conclusion that the period of moratorium would have no application to the personal guarantors of a corporate debtor.
- The Court also considered it appropriate to refer to Section 22 of the erstwhile Sick Industrial Companies (Special Provisions) Act, 1985 (SICA), which *inter alia* provided that no suit for the enforcement of any guarantee in respect of loans or advances granted to the industrial company shall lie/be proceeded with, except with the consent of the Board of Industrial and Financial Reconstruction (BIFR) or the Appellate Authority.
- In this context, the Court noted that SICA was repealed on 1 December 2016 and Section 14 of the Code was brought into force with effect from the same date. The Court, therefore, concluded that the Parliament, while enacting Section 14, had this history in mind and specifically did not provide for any moratorium along the lines of Section 22 of SICA.

On the scheme of Section 60

- The Court observed that Section 60(1) of the Code, which provided that the adjudicating authority in relation to the insolvency resolution and liquidation of both corporate debtors and personal guarantors shall be the NCLT, was only important in that it locates the NCLT which would have the territorial jurisdiction in proceedings against corporate debtors. In stating so, the Court turned down the argument of Veasons and Mr. Ramakrishnan (the Respondents) that the period of moratorium extends to the guarantor as well.
- The Court also noticed the reference to 'personal guarantors' in sub-sections (2) and (3) of Section 60 and went on to clarify the scheme of these provisions. It observed that the moment there was a proceeding pending against the corporate debtor under the Code, any bankruptcy or insolvency resolution proceeding against the individual personal guarantor would have to be transferred or filed before the NCLT, as the case maybe.
- However, the Court also clarified that until Part III of the Code is brought into force, the NCLT shall decide the proceedings pertaining to personal guarantors only in accordance with the Presidency-Towns Insolvency Act, 1909 or the Provincial Insolvency Act, 1920 as the case may be.

ERGO | SUPREME COURT SETTLES THE DEBATE: NO MORATORIUM FOR PERSONAL GUARANTORS UNDER SECTION 14 OF THE INSOLVENCY CODE

On the amendment to Section 2(e) of the Code

- By way of the Insolvency and Bankruptcy Code (Amendment) Act, 2017 (Amendment Act), Section 2(e) of the Code was substituted with effect from 23 November 2017 to bring personal guarantors within the ambit of the Code. This amendment, along with Section 60, was heavily relied upon by the Respondents to contend that the period of moratorium extends to the guarantor as well. The Respondents also placed reliance on the Statement of Objects of the Amendment Act, wherein one of the objectives was to extend the provisions of the Code to personal guarantors with a view to further strengthen the corporate insolvency resolution process.
- The Court, in response to the arguments elucidated above, observed that Section 2(e) shall apply only for the limited purpose contained in sub-sections (2) and (3) of Section 60 of the Code. In view of the Court, this was the true purport behind the objective to “further strengthen the corporate insolvency resolution process”.

On Sections 96 and 101 of the Code

- In support of the argument that the period of moratorium does not extend to personal guarantors, SBI placed heavy reliance on Part III of the Code, and in particular, on Sections 96 and 101. It was argued that even though Part III of the Code was not yet in force, if any insolvency resolution process was to be carried out against a personal guarantor, it could have been done only under Part III of the Code - which contains separate moratorium provisions, namely, Sections 96 and 101.
- The Court accepted the above submission and further noted that the protection of moratorium under the above Sections was far greater than that of Section 14. This was because under these Sections, the pending proceedings in relation to the debt (and not the debtor) are stayed. In this context, the Court further observed that the object of the Code was to not allow guarantors, who in the case of corporate debtors were mostly Directors in management of the company, to escape from an independent and co-extensive liability to pay off the entire outstanding debt.
- The Court further relied upon the judgment in *State of Kerala & Ors v Mar Appraem Kuri Co. Ltd. & Anr* [(2012) 7 SCC 106] to substantiate the argument that even though Part III was not in force, it was certainly open for the Court to, for the purpose of interpretation, rely upon Sections 96 and 101 as any law made by the Legislature was law on the statute book even though it may not have been brought into force.

On the argument under Section 31 of the Code

- The Court also considered the emphasis of SBI on Section 31 of the Code, which *inter alia* provides that once a resolution plan as approved by the committee of creditors takes effect, it shall be binding on the corporate debtor as well as the personal guarantor.
- The Court noted that this was only for the reason that otherwise, under Section 133 of the Indian Contract Act, 1872, any change made to the debt owed by the corporate debtor, without the surety's consent, would relieve the guarantor from payment.

SUPREME COURT SETTLES THE DEBATE: NO MORATORIUM FOR PERSONAL GUARANTORS UNDER SECTION 14 OF THE INSOLVENCY CODE

- The Court further observed that in fact, Section 31(1) made it clear that the guarantor cannot escape payment as the approved Resolution Plan may well include provisions as to payments to be made by such guarantor.

On the Amendment Ordinance

- The Court noted that SBI placed heavy reliance on the substitution of Section 14(3) by way of the Ordinance dated 6 June 2018. However, the Respondents contended that the Ordinance could not have retrospective operation and therefore, would not have a bearing on the present appeals.
- In response to the above argument, the Court observed that the amendment was clarificatory in nature and therefore, could be retrospective in its operation. In support of the argument that the Ordinance was clarificatory in nature, the Court also relied upon the Report dated 26 March 2018 prepared by the Insolvency Law Committee. The Committee had suggested that the intention of Section 14 was not to bar actions against assets of guarantors to the debts of the corporate debtors and had consequently, recommended that an explanation to clarify this may be inserted in Section 14 of the Code.

For the reasons explained above, the Court set aside the Impugned Judgment and accordingly, allowed the appeals.

Comment

The judgment provides clarity and settles the confusion caused as a result of conflicting decisions on this issue. It also assumes significance in as much as it paves the way for the Ordinance, promulgated on 06.06.2018, to have retrospective operation at least in the context of Section 14 citing the 'clarificatory' nature of the amendment.

Interestingly, the judgment also highlights the 'difficulty' faced by the Court when hearing the matter owing to the fact that different provisions of the Code were brought into force on different dates. In particular, the question of whether Part III of the Code was in force also caused some confusion during the hearing, pursuant to which the Court decided to appoint an *amicus curiae* to assist them in the matter.

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