

INSOLVENCY OF PERSONAL GUARANTORS

The next big move in Insolvency Regime



ORGANIZED BY: AHMEDABAD CHAPTER OF WIRC OF ICSI

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Presentation Overview

❖ FRAMEWORK FOR PERSONAL GUARANTORS
UNDER IBC

❖ INSOLVENCY RESOLUTION PROCESS

❖ BANKRUPTCY PROCESS



**FRAMEWORK FOR PERSONAL GUARANTORS
UNDER IBC**

BASIC INTRODUCTION

The law pertaining to the Personal Guarantors seems to be the next big development in the fast-paced growth of the Insolvency Regime in India under **IBC, 2016**.

The Insolvency Procedure of Personal Guarantors in India is a thin line between the **Contract Law and Insolvency Law**.

The Insolvency and Bankruptcy Code, 2016 (“Code”) is one of the most prolific legislative changes in the last few years, spurring furious litigation, multiple legal interpretations, regular amendments and is ever evolving to deal with the non-performing assets of various financial institutions in India.

In the Indian Context, the **personal guarantors are most likely the promoters** or the family members of the promoters or directors, who are closely associated to the company. This is mostly given as there is need to meet the ever growing working capital requirements or as part of the usual business practice.

WHO IS PERSONAL GUARANTOR?

Section 5 (22) of the IBC defines a personal guarantor as *an individual **who is the surety in a contract of guarantee to the corporate debtor.***

Pursuant to Rule 3 (e) of the Insolvency and Bankruptcy (Application to Adjudicating Authority for Insolvency Resolution Process for Personal Guarantors to Corporate Debtors) Rules, 2019 ("**Rules**"), a guarantor means a debtor who is a personal guarantor to a corporate debtor in respect of whom **guarantee has been invoked by the creditor and remains unpaid in full or in part.**

FRAMEWORK FOR PERSONAL INSOLVENCY

Insolvency and Bankruptcy Code

Corporate

Minimum default
Rs. 100,00,000/-
(Rs. One crore)

Companies, LLPs

Non-Corporate

Minimum default
Rs. 1,000/-

Individuals

Partnership Firms

Individuals without
any business

Individuals having
business/ propriety
(Sole
proprietorships)

Personal
Guarantors to
Corporate
Debtor

As the law stands today only provisions relating to personal guarantors have been notified.

TIMELINE OF PERSONAL INSOLVENCY

28.05.2016

The IB Code, 2016 Was Enacted



26.04.2019

Draft Regulations for Bankruptcy Process of Personal Guarantors of Corporate Debtor
08.05.2019 Draft Rules for Insolvency Process of Personal Guarantors of Corporate Debtor



15.11.2019

Sections of the Code & Rules for Personal Guarantor notified
20.11.2019 Reg. for Personal insolvency and Bankruptcy Process



01.12.2019

Provisions for Personal Insolvency (along with Rules and Reg.) shall be **effective**



LANDMARK JUDGMENTS IN THIS REGARD

Reliance Communication



The Supreme Court dismissed State Bank of India's (SBI's) plea seeking the vacation of a **stay granted by the Delhi High Court** on bankruptcy proceedings against Reliance Communications (RCom), Chairman Anil Ambani had earlier objected to the SBI invoking personal guarantees under the Corporate Debtors Regulations, 2019.

In late August, the Delhi High Court had put on hold the insolvency resolution process (IRP) proceedings against Anil Ambani in relation to the recovery. **Ambani had given personal guarantees for the Rs 565 crore and Rs 635 crore** SBI loans to RCom and Reliance Infratel (RITL), respectively, in August 2016.

Ambani in his plea in the Delhi High Court had challenged the constitutionality of the IBBI (Insolvency Resolution Process for Personal Guarantors to Corporate Debtors) Regulations, 2019 **(Source:- Business Standard)**

SC upholds Insolvency Resolution Process for Personal Guarantors on 21.05.2021

Lalit Kumar Jain Vs Union of India

- Surety and Principal liability are co-extensive.
- Contract of surety and variation in terms with principal
- Resolution plan of CD

Summary of the Supreme Court Judgement

1. OBJECTIVE AND INSTITUTIONAL FRAMEWORK UNDER THE CODE

- (a) The Code aimed at **aligning insolvency laws with international standards**
 - (i) promote entrepreneurship and availability of credit;
 - (ii) ensure the balanced interests of all stakeholders and
 - (iii) promote time-bound resolution of insolvency in case of corporate persons, partnership firms and individuals.
 - (iv) Corporate governance and time bound resolution of the Insolvency.

2. NOTIFICATION DATED 15TH NOVEMBER, 2019.

- (a) The impugned notification is not an instance of legislative exercise or amounting to impermissible and selective application of provisions of the Code. **There is no compulsion in the Code that it should, at the same time, be made applicable to all individuals, (including PGs) or not at all. There is sufficient indication in the Code- by sections 2(e), 5(22), 60 and 179** indicating that PGs, though forming part of the larger grouping of individuals, were to be, in view of their intrinsic connection with CDs, dealt with differently, through the same adjudicatory process and by the same forum.
- (b) The impugned notification inter alia makes the provisions of the Code applicable in respect of PGs to CDs, as another category of persons to whom the Code has been extended.
- (c) **The notification was issued within the power granted by Parliament**, and in valid exercise of it. The **exercise of power in issuing the Notification** under section 1(3) is therefore, **not ultra vires and accordingly, is valid.**

3. LIABILITY OF A PG TO CD IN CASE RESOLUTION PLAN IS APPROVED.

- (a) Language of **section 31 of the Code** makes it clear that the **approved plan is binding on the guarantor**, to avoid any attempt to escape liability under the provisions of the Contract Act, 1972.
- (b) **The sanction of a resolution plan and finality imparted to it by section 31 does not per se operate as a discharge of the guarantor's liability.**
- (c) **Approval of a resolution plan does not ipso facto discharge a PG of a CD of her or his liabilities under the contract of guarantee.** 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 proceeding, does not absolve the surety/guarantor** of his or her liability, which arises out of an **independent contract.**

Sections 94 to 187 of the Insolvency and Bankruptcy Code, 2016(IBC), read with sec. 60 (1) and (2), w.r.t. insolvency and bankruptcy of personal insolvency of corporate guarantors have been notified vide notification dated 15.11.2019, along with rules and regulations for insolvency and bankruptcy process of Personal Guarantors.

Some important provisions: Section 94 and 95: Initiate Insolvency Process against Individuals

Section 96: Interim Moratorium

Section 99: Submission of Report by Resolution Professional

Section 100: Admission or rejection of application

Section 101: Moratorium

Section 105: Repayment Plan

Section 110: Rights of secured creditors in relation to repayment plan

Section 116: Implementation and supervision of repayment plan

Section 119: Discharge Order

Jurisdiction of NCLT for CD, CG and PG



Corporate
Debtor
CD

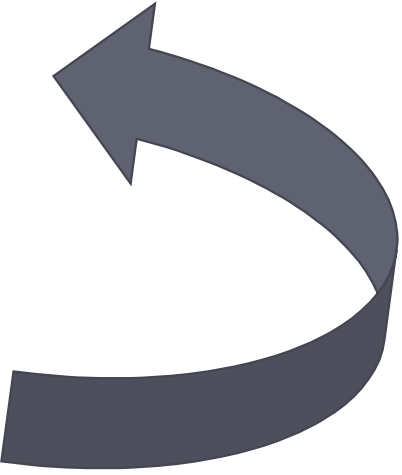
Corporate
Guarantor
CG

Personal
Guarantor
PG to CD



CD
Mumbai

CG
Delhi



Jurisdiction
will get
transferred to
NCLT where
CD is
admitted

Section 60 (2)

***PNB Vs Essar Shipping
Limited
NCLT Ahmedabad***



CD
Mumbai

Personal
Guarantor
PG to CD



**Jurisdiction will
get transferred
to NCLT of PG to
CD
Section 60 (2)**

**NCLT
Mumbai**

Two applications can be maintained for the same debt against CG and CD

Dr. Vishnu Kumar Agarwal Vs. M/s. Piramal Enterprises Ltd. [2019] ibclaw.in 16 NCLAT & Shabad Khan Vs. M/s. Nisus Finance and Investment Manager & Ors. [2020] ibclaw.in 118 NCLAT


If two Applications can be filed, for the same amount against Principal Borrower and Guarantor keeping in view the Sec. 60(2) & (3) of IBC, the Applications can also be maintained- **State Bank of India Vs. Athena Energy Ventures Private Limited (2020) ibclaw.in 344 NCLAT**

Whether a Bank/Financial Institution can institute or continue with proceedings against a Guarantor under the SARFAESI Act, when proceedings under the IBC have been initiated against the *Principal Borrower* & *the same are pending adjudication* –

Kiran Gupta Vs. State Bank of India & Anr. (2020)

ibclaw.in 320 NCLAT &

Industrial Investment Bank of India Limited v. Biswanath Jhunjhunwala [2017] ibclaw.in 24 SC.



“The view expressed by the Supreme Court amply demonstrates that neither [Section 14](#) nor Section 31 of the IB Code place any fetters on Banks/Financial Institutions from initiation and continuation of the proceedings against the guarantor for recovering their dues.

That being the position, the plea taken by the counsel for the petitioner that all proceedings against the petitioner, who is only a guarantor, ought to be stayed under the SARFESI Act during the continuation of the Insolvency Resolution process qua the Principal Borrower, is rejected as meritless. The petitioner cannot escape her liability qua the respondent/Bank in such a manner”



INSOLVENCY RESOLUTION PROCESS

INSOLVENCY RESOLUTION PROCESS

Pursuant to Section 60 of the IBC, the **National Company Law Tribunal (“NCLT”)** has the **territorial jurisdiction** in relation to the insolvency resolution for corporate persons including the corporate debtors and personal guarantors.

The insolvency and bankruptcy procedure can be initiated against a personal guarantor, either by a creditor or through a resolution professional pursuant to Section 95 of the IBC by filing an application before the NCLT.

The **Debtor (U/s 94) filed by a debtor** (in Form A); **who has committed default** of debt, other than **excluded debt**; Either personally or through a Resolution Professional (RP) & in case of partnership consent required from majority partners.

The **Creditor (U/s 95)** filed by a creditor (in Form C); **Invocation of guarantee- a precondition.** either **individually or jointly** with other creditors; directly or through a Resolution Professional (RP), Only if debtors **fails to pay within 14 days** of service of demand notice (in Form B).

Application for Insolvency Resolution Process for personal guarantor-

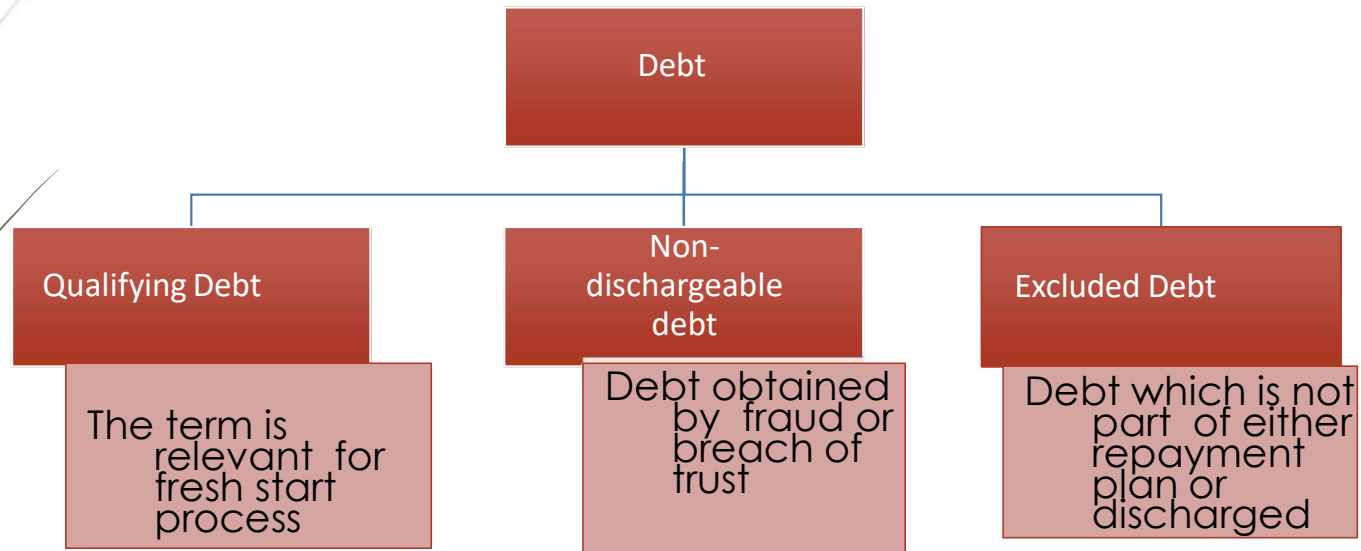
1) by guarantor personally or through RP (Form A u/s 94) **along-with two thousand rupees.**

2) By Creditor (Section 95)

- Demand notice by creditor personally demanding payment [Form B]
14days

- **Application by creditor personally or through RP (Form C u/s 95) along-with two thousand rupees** after expiry of 14 days from the date of demand notice.

DEBT



EXCLUDED DEBT

Fine imposed by
Court/ Tribunal

Damages for
negligence, breach
of stat. obligation

Maintenance to
pay any person
under any law

Liability w.r.t. a
student loan

Any other debt, as
may be prescribed
—no such
prescription yet

EXCLUDED ASSETS

Sec 79 (14) read with Rule 5



Unencumbered tools, vehicles and other equipments, necessary for employment, business or vocation.



Unencumbered furniture, equipment, necessary for basic domestic needs



Unencumbered personal ornaments, that cannot be parted with in accordance with religious usage

Upto Rs.
1,00,000/-



Unencumbered life insurance policy/
pension plan

Upto Rs.
20,00,000/- in
Urban area;
Rs. 10,00,000/-
in rural area



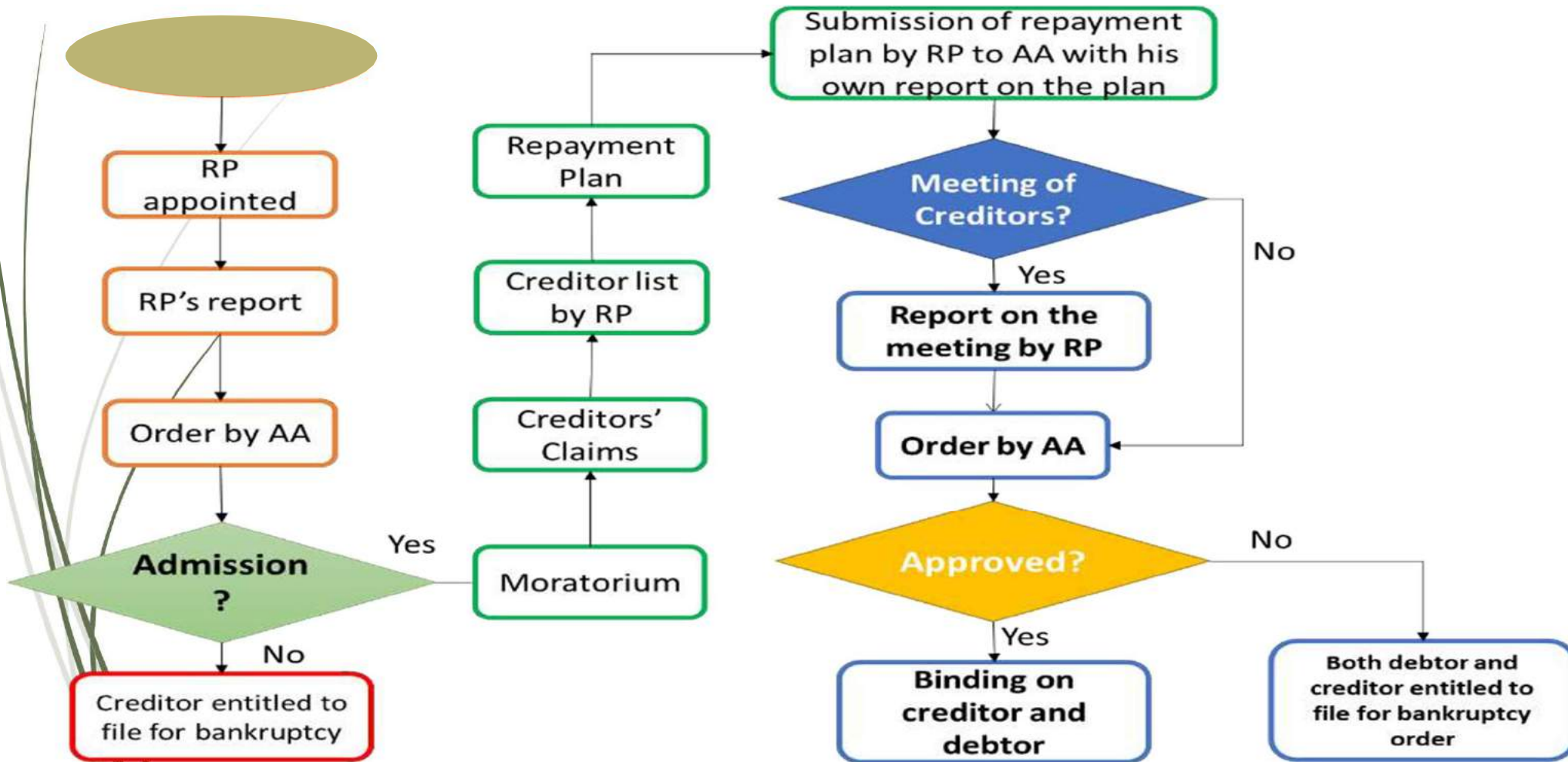
Unencumbered single dwelling unit

1. DEMAND NOTICE

Pursuant to Rule 7 (1) of the Rules, a demand notice shall be served by the creditor on the personal guarantor demanding the payment of amount in default and ***such demand notice shall be served on the personal guarantor in Form B. Within 14 (fourteen) days from the date of receipt of the demand notice, the personal guarantor shall pay the debt amount to the creditor,*** failing which the creditor reserves the right to file an insolvency application before the NCLT.

Unlike demand notice in Form 3 of the IBBI (Application to Adjudicating Authority) Rules, 2016, the **demand notice in case of personal insolvency does not give a chance of disputing the notice.**

2. FILING OF APPLICATION



MORATORIUM

INTERIM (Section 96)

From date of filing of application
till its admission

FINAL (Section 101)

From admission of Application till
180 days or approval of Repayment
Plan, whichever is earlier

3. INTERIM MORATORIUM (Section 96)

During the interim-moratorium period –

(i) any pending legal action or proceeding in respect of any debt shall be deemed to have been stayed; and

(ii) the creditors of the debtor shall not initiate any legal action or proceedings in respect of any debt.

4. FINAL MORATORIUM (Section 101)

During the moratorium period-

(a) any pending legal action or proceeding in respect of any debt shall be deemed to have been stayed;

(b) the creditors shall not initiate any legal action or legal proceedings in respect of any debt; and

(c) the debtor shall not transfer, alienate, encumber or dispose of any of the assets or his legal right or beneficial interest therein;



*P Mohaníaj and oīheís v M/s Shah Bíoīheís
Ispaī Līd
(Oídeí daīed 01.03.2021 passed in Civil appeal
No. 10355 of 2018)*


Supreme Court held that the benefit of Section 14 shall apply to Corporate Debtor and not to the “natural persons”

In a way, no benefit to extend on directors/signatory

Vicarious liability
Strict Liability

Sanjeevani Booti = Moratorium

Moratorium u/s 14 Vs 101



**SECTION 104.
PREPARATION OF
LIST OF CREDITORS**

RP prepare list on the
basis of claims
received

The resolution
professional shall
prepare the list within
30 from Notice

the information
disclosed in the
application by the
debtor

Claims Received by
RP

Provide copy of list of
creditors to creditors
and AA

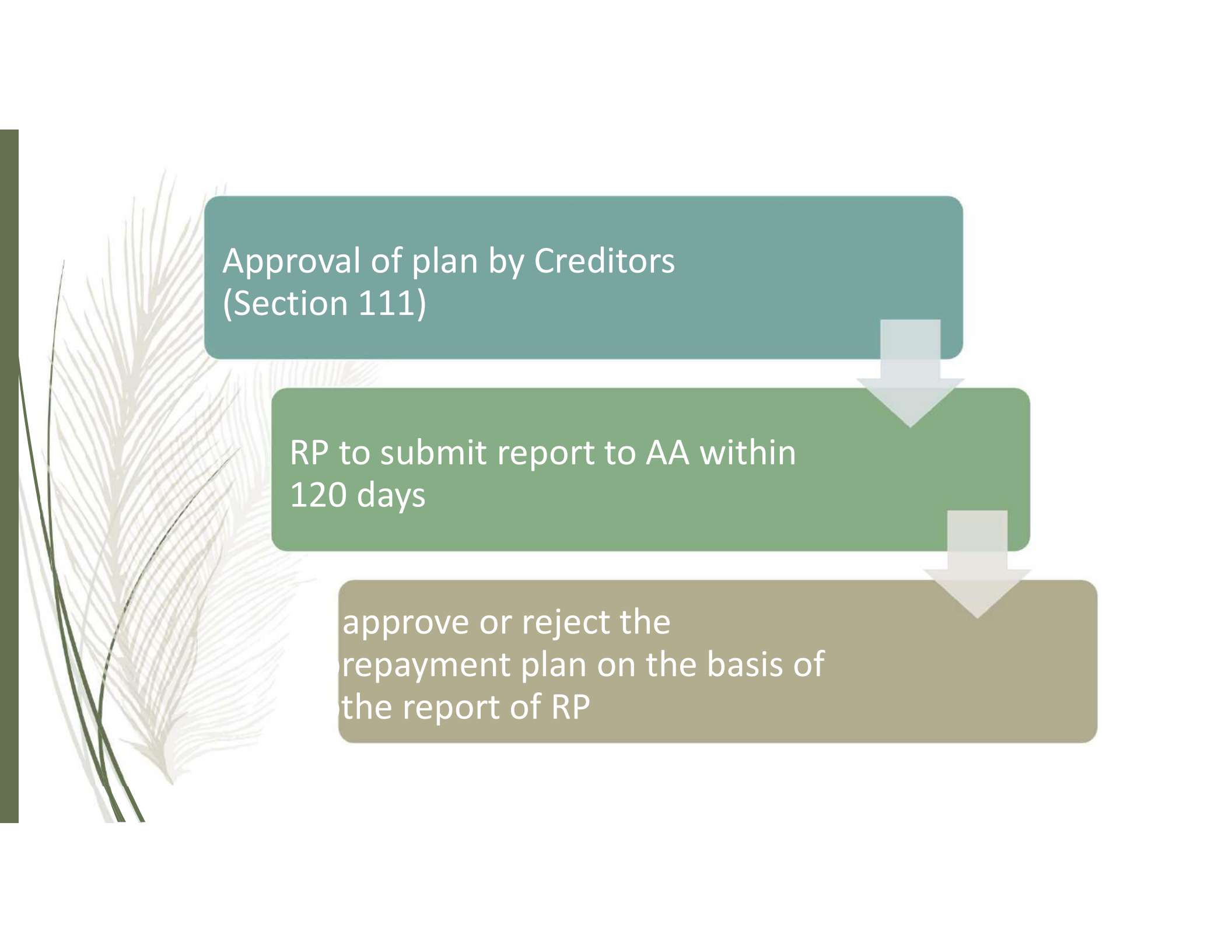
5. APPROVAL OF THE REPAYMENT PLAN

The repayment plan or such modification to the repayment plan shall be approved by the majority of $3/4^{\text{th}}$ in value of the creditors in person or through proxy and the voting on the meeting of the creditors and 50% for other resolutions.

Illustration:

Mr. A is under going insolvency process, wherein Mr. B is appointed as the RP. On the basis of public announcement, claims have been received from 10 creditors of total value Rs. 5,00,000/-

Repayment Plan is placed before the creditors for approval. Only 6 creditors having dues of Rs. 3,50,000/- and above can approve the repayment plan.



Approval of plan by Creditors
(Section 111)

RP to submit report to AA within
120 days

approve or reject the
repayment plan on the basis of
the report of RP

6. EFFECT OF APPROVAL OF REPAYMENT PLAN

Become effective as if proposed by debtor

Be binding on the creditors mentioned in the Plan

Once approved, the Plan shall:

RP shall supervise the implementation of the Plan

AA may issue specific direction w.r.t. implementation

7. COMPLETION OF REPAYMENT PLAN

Full Completion of Plan (sec. 117)

RP shall notify all persons bound by the Plan, that the Plan has been fully implemented

Report w.r.t. all receipts & payments pursuant to implementation of Plan shall be sent to all persons bound by the Plan

Premature Termination of Plan (sec. 118)

RP shall submit report stating reasons for premature end of repayment plan;
Details of creditors whose dues have not been paid as per Plan

Creditors whose claims have not been fully satisfied may apply for bankruptcy order.

8. WITHDRAWAL OF APPLICATION

Withdrawal of Application Rule 11



Before admission

On the request of applicant

After admission

On request of applicant and 90% of creditors approval for withdrawal



COMPARISON BETWEEN INSOLVENCY OF PERSONAL GUARANTORS & CORPORATE INSOLVENCY



Point	Personal Insolvency	Corporate Insolvency
Distinction between creditors	No classification w.r.t. type of creditor i.e. operational or financial	Three classes of creditors – financial, operational, other
Withdrawal of Application	Yes Requires 90% consent of creditors	Yes Requires 90% consent of CoC
CoC	No concept of CoC- a general list of creditors is formed	Constitution of CoC mandatory- shall comprise of financial creditors only.
Meeting of Creditors	Not Mandatory- shall be conducted if deemed necessary by the RP – subject to conditions	Mandatory to conduct the CoC
Moratorium	Yes	Yes
Interim Moratorium	Yes	No
Approval of Plan	Requires 75% assent of creditors present and voting	Requires 66% assent of CoC
Rejection of plan	Application for bankruptcy may be filed	Leads to compulsory liquidation
Role of the IP	Pre-scrutiny of the insolvency application and repayment plan by the RP	RP does not come into picture until admission



BANKRUPTCY PROCESS

WHO IS A BANKRUPT?

- “Bank” + “rupt”
 - ‘bank’ means ‘bench or a place of business’
 - ‘rupt’ derived from ‘ruptus’ means ‘broken’
- ‘Bankrupt’ is ‘bankrupt’ only when he is adjudged as such

“bankrupt” means—

(a) a debtor who has been adjudged as bankrupt by a bankruptcy order under section 126;

(b) each of the partners of a firm, where a bankruptcy order under section 126 has been made against a firm; or

(c) any person adjudged as an undischarged insolvent

APPLICATION FOR BANKRUPTCY ORDER

- Insolvency Process is a **pre-condition-**
- direct application for bankruptcy not allowed.
- **Possible by debtor/creditor**
 - Creditor-individually or jointly
 - In case debtor is a firm, application may be filed by any of its partners
- **Within 3 months** of the order passed by AA under Section 100(4), or 115(2), or 118(3), as the case may be (refer succeeding slide)
- Applicant may propose an **insolvency professional to act as bankruptcy trustee;**
- Application shall not be withdrawn **without the leave of AA.**
- Interim moratorium commences once application is filed (Sec. 124 (1)(a))
 - Terminates on bankruptcy commencement date
 - Debars all actions against properties of the debtor in respect of his debts
 - Creditors not entitled to initiate legal actions against properties in respect of any of the debts of the debtor.

Note : Such interim-moratorium provisions not to apply to transactions notified by the Central Government in consultation with any financial sector regulator.

WHEN IS APPLICATION FILED?

Application for IRP is rejected by AA under Section 100(4)

Creditor entitled to file application

Order by AA recording rejection of repayment plan by meeting of creditors (Section 115(2))

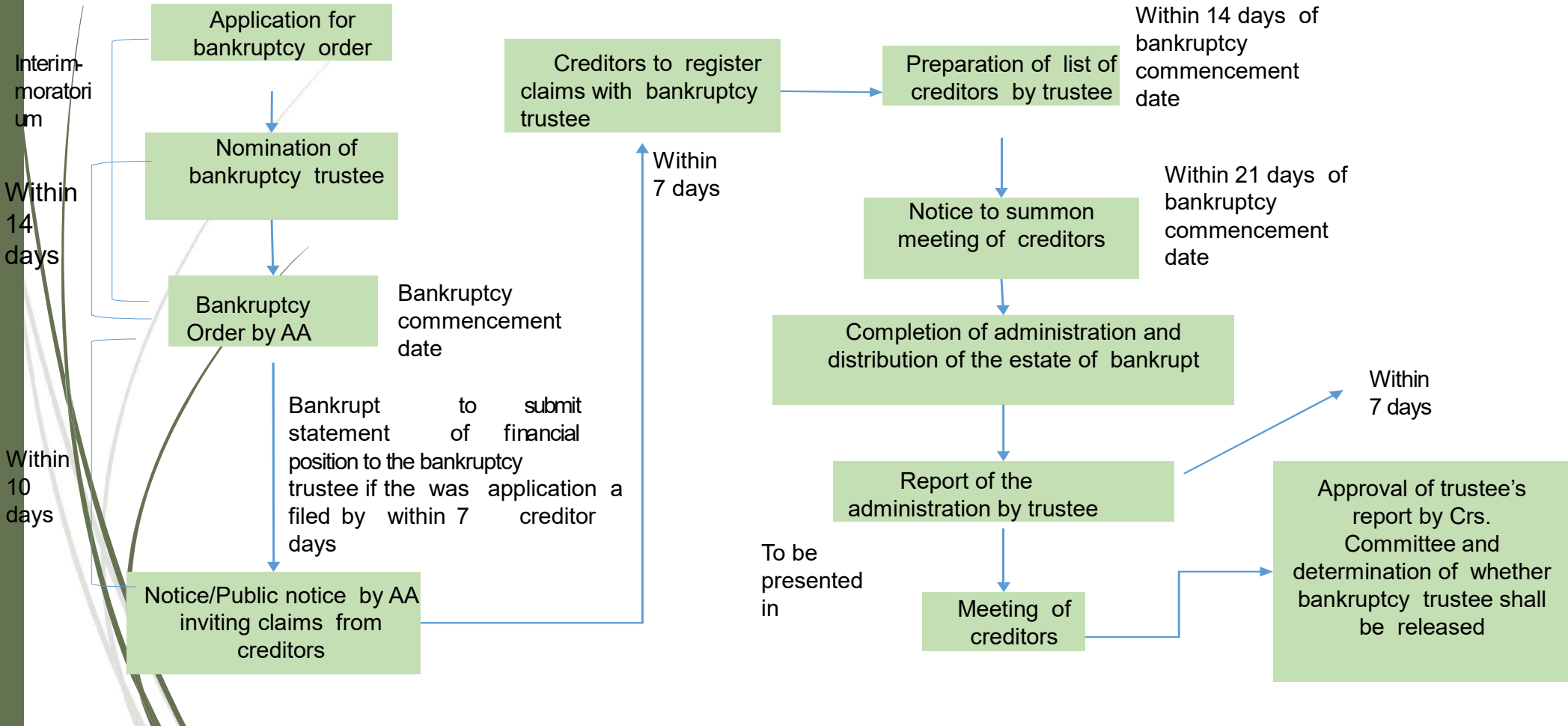
Both debtor and creditor entitled to apply

Order of AA on premature ending of the repayment plan under Section 118(3)

The debtor or the creditor, whose claims have not been fully satisfied entitled to apply

Application for Bankruptcy (Sec. 122 & 123)

BANKRUPTCY PROCESS



EFFECT OF BANKRUPTCY ORDER

(Sec 128): Upon passing of the bankruptcy order, the immediate effect is as follows

Bankruptcy Estate

- Bankruptcy estate shall vest with the bankruptcy trustee

Moratorium

- Bankrupt shall be immune from any action by the creditors w.r.t. (a) Property of the bankrupt; (b) any legal proceedings without permission of AA

Division of Estate

- The estate shall be divided amongst the creditors

THE BANKRUPTCY MORATORIUM – SEC. 128 (1) (C)

Blocks these:

- A creditor shall not initiate any action against property of the bankrupt
 - A creditor shall not commence any suit or other legal proceeding except with the leave of the AA
- Note the bar is only on a creditor – if there is a monetary implication against the debtor, the claimant becomes a creditor
- Can excluded debts be recovered? Usually AA should not object to recovery of an excluded debt by any action
- Fines, damages, maintenance obligation, etc

Does not block these:

- Enforcement action by secured creditor – sec 128 (2)
- Punitive action for personal misconduct, such as contempt of court
- Ruling in *Smith vs Braintree DC [1990] 2 AC 215* – criminal proceedings not stayed; quasi-criminal proceedings, with predominant purpose of enforcing a payment, may get stayed.

CORPORATE BANKRUPTCY VS. PERSONAL BANKRUPTCY (1/2)

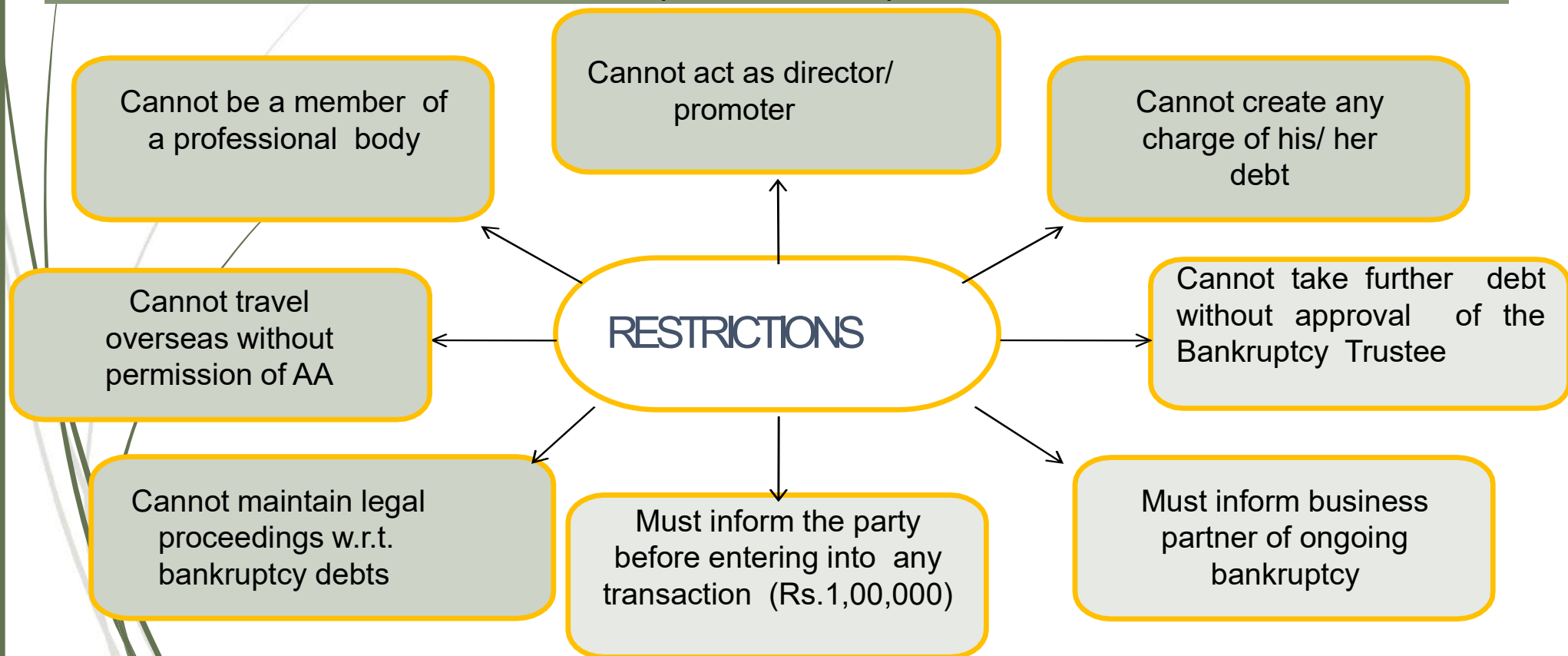
Point of difference	Liquidation	Bankruptcy
Manner of initiation	Automatically triggered u/s 33	Creditor/debtor become entitled to file for bankruptcy Section 100 – Rejection of insolvency resolution application by AA. Section 115 – Rejection of repayment plan by AA. Section 118 – Premature closing of repayment plan Note undischarged insolvent u/s 92 (2) may also be adjudged as bankrupt
Reversibility/modification or recall	No specific provision – right to appeal against AA's order – section 61.	Possible – by AA, on application or suo-motu – section 142 (either erroneous initiation or full repayment).
Interim-moratorium	No	Yes – sec. 124 (1)- on application – lasts till bankruptcy order is passed
Moratorium	Sec. 33 - On liquidation order being passed	Sec. 128 - On bankruptcy order being passed
Role of Insolvency Professional	As liquidator	As bankruptcy trustee
Estate of debtor	Liquidation estate held by liquidator as fiduciary for benefit of all creditors – section 36	Estate of the bankrupt vests in the bankruptcy trustee – section 154
Manner of vesting of estate	No conveyance, assignment – the estate is constructive	Section 154(2) provides that there is no need for conveyance, assignment or transfer for vesting of property in the trustee.

PERSONAL BANKRUPTCY V/S CORPORATE BANKRUPTCY (2/2)

Point of difference	Liquidation	Bankruptcy
Involvement of creditors.	Liquidator has the constitute Stakeholder's Consultation Committee (including No provision for a committee of administration of the estate; the bankruptcy requires approval of the committee of creditors decides on	Considerable - meeting of creditors summoned, a committee of creditors is appointed for approval of the report on committee for several acts (section 153), and the the release of the bankruptcy trustee.
Priority of pay-out from estate not exist [even if the individual is carrying on business]	Sec. 53 – financial debts take priority over operational debts	Sec. 178 – distinction b/w financial creditor and operational creditor does not exist [even if the individual is carrying on business]
Final Stage from all bankruptcy debts.	Dissolution – the entity loses its existence.	Discharge – releases the bankrupt from all bankruptcy debts.

RESTRICTIONS ON A BANKRUPT

Sec. 141: Apart from disqualifications bankruptcy order also attracts the following restrictions upon the bankrupt





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You may also connect on:

