

# APPLICABILITY OF MORATORIUM ON GUARANTOR'S ASSETS: THROUGH MAZE OF RULINGS

- **Barsha Dikshit**

**Editor's Note:** *The extent of the role of personal guarantors in the insolvency resolution process has been much talked about. Similarly, there have also been questions whether moratorium outreaches the assets of the personal guarantors too. Varying stance taken by the Adjudicating Authority on this issue have been discussed and analysed hereunder*

The Code envisages calm period during the corporate insolvency resolution process of the corporate debtor. Section 14 of the Code requires the adjudicating authority to declare "moratorium" during which institution or continuation of suits, execution of any decree or order, or alienation or transfer of assets of the corporate debtor is prohibited. The moratorium also bars any action to foreclose, recover or enforce any security interest created by the corporate debtor in respect of its property including any action under the SARFAESI Act, 2002.

In the context above, the effect of the moratorium provisions on the assets of the *personal guarantors* of the corporate debtor has been a matter of debate before the adjudicating and appellate authorities. The latest judgment rendered in [State Bank of India v. V Ramakrishnan and Vecons Energy Limited](#) [Company Appeal (AT) (Insolvency) No. 213 of 2017] by the National Company Law Appellate Tribunal (NCLAT) goes on to abstruse the issue.

The NCLAT has held that on admission of the insolvency resolution application under the Code, the moratorium will not only be applicable to the property of the corporate debtor *but also* on the property of the personal guarantor. The view taken by NCLAT in the said ruling deviates from the judgements rendered by the appellate authority in [Alpha & Omega Diagnostics \(India\) Ltd. v. Asset Reconstruction Company of India Ltd. & Ors.](#) [Company Appeal (AT) (Insol.) No. 116 of 2017], and later in [Schweitzer Systemtek India Pvt. Ltd v. Phoenix ARC Pvt. Ltd. & Ors](#) [Company Appeal (AT) (Insolvency) No. 129 of 2017]<sup>34</sup>, as discussed below.

## **Alpha & Omega Diagnostics (India) Ltd. v. Asset Reconstruction Company of India Ltd. & Ors**

In the matter of *Alpha & Omega Diagnostics (India) Ltd. Vs. Assets Reconstruction Company of India Ltd. And ors*, wherein, personal property of the promoters was given as security against the loan taken by the Corporate Debtor, the Hon'ble NCLAT had ruled that corporate debtor is distinct from the guarantor and that the corporate debtor has applied for "its" own insolvency resolution proceedings and the assets would only include the assets of the corporate debtor and not of any third-party including the promoters.

Section 14 (1) (c) of IBC, 2016, itself clarifies its ambit which is limited to the properties of the Corporate Debtor alone. As held by the NCLAT in case of Alpha & Omega, Every word is to be read and interpreted as it exists in the statute with the natural meaning attached to the word. On simple reading of the section, it is very clear that the provision connects to the security interest created by the corporate debtor in respect of its own property. There is no scope of protection to the assets of the guarantor (be it personal or corporate) under the moratorium provisions of section 14.

***Schweitzer Systemtek India Pvt. Ltd v. Phoenix ARC Pvt. Ltd. & Ors.***

In the matter of *Schweitzer Systemtek India Pvt. Ltd v. Phoenix ARC Pvt. Ltd. & Ors.*, wherein the property of the guarantor was attached during corporate insolvency resolution process and the issue was whether moratorium under the Code would be applicable on the property of the promoters or not. The Hon'ble NCLAT in the said matter had placed reliance on section 14 (1) (c) of IBC, 2016, which reads as follows:

*“Section 14 (1) :- Subject to provisions of sub-sections (2) and (3), on the insolvency commencement date, the Adjudicating Authority shall by order declare moratorium for prohibiting all of the following, namely:—*

*Xx*

*(c) any action to foreclose, recover or enforce any security interest created by the corporate debtor in respect of its property including any action under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;*

*Xx.”*

The Hon'ble NCLAT in the abovementioned case had recourse strict interpretation of the word “its” and has ruled that the language of the section is so simple that there is no scope to even supply *casus omissus*. Thus, the property not owned by the corporate debtor do not fall within the purview of the Moratorium. In other word, the moratorium shall prohibit the action against the properties of the corporate debtor that reflects in its balance sheet and not on the properties beyond the ownership of the corporate debtor.

***State Bank of India v. V Ramakrishnan and Veasons Energy Limited (supra), Mr. V. Ramakrishnan***

In *State Bank of India v. V Ramakrishnan and Veasons Energy Limited (supra)*, Mr. V. Ramakrishnan, director of Veasons Energy Limited (“the Corporate Debtor”), has given personal guarantee and has mortgaged collateral security of his assets with State Bank of India (“the Financial Creditor”) against the facility availed by the Corporate Debtor. The Financial Creditor invoked its right against under SARFAESI against the Personal Guarantor under section 13 (2). The notice was challenged by the Corporate Debtor before Hon'ble High Court of Madras and was dismissed by the Hon'ble Court. Having failed to get relief from the Hon'ble Court, the Corporate Debtor proceeded with application under section 10 of the IBC, 2016. The said application was admitted and moratorium was declared for the Corporate Debtor. However, the financial creditor continued taking measures under SARFAESI against the Financial Creditor. Being aggrieved, the Personal Guarantor filed application before NCLT, Chennai, for stay proceeding under SARFAESI. The Chennai bench allowed the

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application and restrained the financial creditor from proceeding against the personal guarantor till Moratorium continues. This order was challenged by the financial creditor before the NCLAT.

After analysing the contention of both the parties, the Hon'ble NCLAT held that the 'Moratorium' will not only be applicable to the property of the 'Corporate Debtor' but also on the 'Personal Guarantor'.

### **The author's analysis**

As is evident from the foregoing discussion, the decision of the NCLAT in *State Bank of India v. V Ramakrishnan and Veasons Energy Limited(supra)*, stands in contrast with its own decisions rendered in the earlier cases.

Therefore, according to the last view taken by NCLAT, when a corporate debtor is under corporate insolvency resolution process, the creditors can neither proceed against the properties of the corporate debtor, nor against the properties of the guarantor.

Here, it would also be relevant to discuss the case of [Sanjeev Shriya v. State Bank of India & Ors.](#) [Writ-C 30285 of 2017], wherein the High Court held that once the proceeding has already been commenced under the Code and moratorium under section 14 of the Code has already been issued and even in the said proceeding the parties have put their appearance before the insolvency professionals, then the proceeding against the guarantors of principal debtor under the RDBFI Act, 1993 is *per se* bad. Also, once the liability is still in fluid situation and the same has not been crystallized, then in such situation two parallel/split proceedings in different jurisdiction should be avoided, if possible. Therefore, the High Court, in essence, opined that the liability of the guarantor and the corporate debtor in respect of a particular debt is in alternative. Where a corporate debtor is under insolvency resolution (and thus under moratorium), the creditors cannot proceed against the guarantors.

The order of NCLAT in *State Bank of India v. V Ramakrishnan and Veasons Energy Limited* in substance, resonates with the view taken in *Sanjeev Shriya v. State Bank of India & Ors.*

However, the author humbly diverges from the view of the High Court and the NCLAT as above. In *Pollock & Mulla on Indian Contract and Specific Relief Act*, Tenth Edition, at page 728, it is observed-

**“Co-extensive-Surety's liability is co-extensive with that of the principal debtor.**

A surety's liability to pay the debt is not removed by reason of the creditor's omission to sue the principal debtor. The creditor is not bound to exhaust his remedy against the principal before suing the surety, and a suit may be maintained against the surety though the principal has not been sued.”

The principle has been emphasised in a number of rulings.

In [Bank of Bihar Ltd. v. Damodar Prasad & Anr.](#) (1969) 1 SCR 620, the Apex Court referred to a judgment in the case of [Lachhman Joharimal v. Bapu Khandu and Tukaram Khandoji](#)(1869) 6 Bombay High Court Reports 2, in which the Division Bench of the Bombay High Court held-

*“The court is of opinion that a creditor is not bound to exhaust his remedy against the principal debtor before suing the surety and that when a decree is obtained against a surety, it may be enforced in the same manner as a decree for any other debt.”*

The Supreme Court of India has taken a similar view, in the case of *Industrial Investment Bank of India Ltd. v. Biswanath Jhunjhunwala*[Civil Appeal No. 4613 OF 2000] had observed-

*“The very object of the guarantee is defeated if the creditor is asked to postpone his remedies against the surety. In the present case the creditor is a banking company. A guarantee is a collateral security usually taken by a banker. The security will become useless if his rights against the surety can be so easily cut down.”*

Therefore, the NCLAT in *State Bank of India v. V Ramakrishnan and Veasons Energy Limited* completely overlooked its own precedents and the settled principle of co-extensiveness of the liability of principal debtor and that of guarantor.

### Know More . . .

Amidst persisting dilemma w.r.t. applicability of moratorium on the assets of the personal guarantor, the Hon'ble Supreme Court in the matter of [State Bank of India v. Ramakrishnan and Ors.](#) ,clarified that the moratorium is applicable only on the corporate debtor and not the personal guarantors. The Hon'ble Court observed that the law as it stands does not refer to the personal guarantor but only to corporate debtors. The objects and reasons of the Insolvency and Bankruptcy Code state that once a resolution plan approved by the committee of creditors takes effect, it shall be binding on the corporate debtor as well as the guarantor.

**Clearing the Air**

- Moratorium of 180 days will apply only to corporate debtors facing insolvency proceedings

This allows debtor a window within which he has to find a way to clear the debt

Neither can the recovery proceedings be initiated against the debtor nor can his assets be disposed of during this period

- SC has ruled that the law won't apply to personal guarantors such as directors and promoters of the company
- Personal guarantors' assets will be used to cover the bad loans

The infographic features a man in a suit struggling to hold a large ball labeled 'LOAN' with a chain. In the background, two figures are running away from a ball labeled 'DEBT'. A gavel icon is also present.

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