

Remedies Available to Banks to Recover Outstanding Amount from the Personal Guarantor during Moratorium in CIRP



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Abstract

It is expected from the Banking institutions to seek guarantee before sanctioning any loans to the Companies. Usually, Banks insists that the promoter/director who is having majority shares in the company should give their personal guarantee and become a guarantor. However, under the Insolvency and Bankruptcy Code, 2016 when a moratorium is declared and any suit is barred from being pursued, a deadlock appears before the Banks which seeks to recover the liabilities from the Guarantors of the Company. In its ruling the NCLAT and has addressed this concern and clarity has also been brought by the circulars of RBI. This article seeks to examine such rulings and circulars to figure out the legal regime for recovery from Guarantors during insolvency proceedings.

Keywords: Liability of Guarantor; Moratorium and Guarantor; Right of Recovery of Banks; NCLAT judgements on Guarantor.

Introduction

It is expected from the Banking institutions to seek guarantee before sanctioning any loans to the Companies. Usually, Banks insists that the promoter/director who is having majority shares in the company should give their personal guarantee and become a guarantor. Such guarantees are generally in addition to corporate guarantees. Once the promoter directors or any individual or company gives such guarantee, their liability becomes co-extensive with that of the borrower and such guarantors can be held liable as soon as the borrower defaults in payments as Section 128 of the Indian Contracts Act, 1872 prescribes that the liability of a guarantor is co-extensive with that of the borrower. Upon default by the principal debtor, the Banks have the right to start recovery process against the Guarantor. However, in case the borrower is Corporate Debtor and Corporate Insolvency Resolution Process have been initiated against the Corporate Debtor, Section 14 of the I&B Code¹, 2016 provides for a moratorium on all other proceedings against corporate debtor. However, whether a moratorium under Section 14 of the I&B Code, 2016, prevents the Banks from starting or pursuing the recovery proceedings against the personal guarantor of the Corporate Debtor. This issue has recently been settled by a Supreme Court Bench headed Justice R F Nariman in **State Bank of India vs. V Ramakrishan & another**². The Apex Court has observed that:

"[A] plain reading of the said Section, therefore, leads to the conclusion that the moratorium referred to in Section 14 can have no manner of application to personal guarantors of a corporate debtor."

The Respondents in this case argued that since Section 60 of I&B Code, 2016 places jurisdiction on NCLT relating to insolvency of corporate debtor and personal guarantor, the CIRP should also extend to personal guarantor also. However the Court observed that:

"the scheme of Section 60(2) and (3) [of I&B Code, 2017] is thus clear – the moment there is a proceeding against the corporate debtor pending under the 2016 Code, any bankruptcy proceeding against the individual personal guarantor will, if already initiated before the proceeding against the corporate debtor, be transferred to the National Company Law Tribunal or, if initiated after such proceedings had been commenced against the corporate debtor, be filed only in the National Company Law Tribunal. However, the Tribunal is to decide such proceedings only in accordance with

the Presidency-Towns Insolvency Act, 1909 or the Provincial Insolvency Act, 1920, as the case may be."

It was further argued by the Respondents that since Section 31 of I&B Code, 2016 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 guarantor, the CIRP should extend to the personal guarantor as well. The Court however held that:

"5. By the impugned judgment dated 28.02.2018, the Appellate Tribunal relied upon Section 60(2) and (3) of the [I&B] Code as well as Section 31 of the Code to find that the moratorium imposed under Section 14 would apply also to the personal guarantor....."

22. Section 31 [of I&B Code, 2016] was also strongly relied upon by the Respondents. This Section only states 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 guarantor. This is 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. Section 31(1), in fact, makes it clear that the guarantor cannot escape payment as the Resolution Plan, which has been approved, may well include provisions as to payments to be made by such guarantor. This is perhaps the reason that Annexure VI(e) to Form 6 contained in the Rules and Regulation 36(2) referred to above, require information as to personal guarantees that have been given in relation to the debts of the corporate debtor. Far from supporting the stand of the Respondents, it is clear that in point of fact, Section 31 is one more factor in favour of a personal guarantor having to pay for debts due without any moratorium applying to save him."

The Apex Court further clarified that the recent amendment to the Code to the effect that moratorium shall not apply to surety in a contract of guarantee for corporate debtor, is clarificatory in nature and hence retrospective in effect.

Since the issue of non-applicability of moratorium under the Code to the personal guarantors has been settled by the Hon'ble Supreme Court, the Banks will be free to initiate or pursue recovery proceedings against the personal guarantors of the Corporate Debtor. There are various remedies available to Banks to initiate such recovery proceedings against the personal guarantor. Provisions under SARFAESI Act, 2002, the Indian Contract Act, 1872, RDDBFI Act, 1993. The decision of the Bank to initiate recovery proceeding against the personal guarantor, under either of the above mentioned acts, depends upon the facts and circumstances of each case.

Ministry of Finance in consultation with the Reserve Bank of India, issued to all public sectors bank, recommends taking following steps against the guarantors immediately when no sign of revival is visible³:

Proceedings under Section 13 of the SARFAESI Act, 2002

The circular advises the Banking Institution to take steps under Section 13 the SARFAESI Act, 2002 to enforce the guarantee given by any director/promoter of the Company. As per the provisions of the The SARFAESI Act 2002, the Banks are entitled to enforce any guarantee furnished by such directors in case the loan account has turned into a non performing asset. This right of the Banking Institution is to be enforced without any involvement of the Courts. It is of wide amplitude. Section 13 (2) of the Act empowers the Banks to serve a notice to the borrower, upon the account becoming an Non Performing Asset (NPA), for taking possession of the assets held as security for the money lent by it, after serving a notice to the borrower to discharge his full liabilities within 60 days from the date of notice. It is also required that the notice should detail out the legal consequences and penal provisions. However, if the borrower is a willful defaulter having adequate means to pay but is not paying the outstanding amount willfully, the SARFAESI proceedings can be started against such willful defaulters even without serving any prior notice. The Reserve Bank of India vide its circular dated 09.09.2014⁴ has stated that individuals who act as guarantors to loans can be treated as 'Willful Defaulters' if they refuse to clear the amounts due despite having the requisite means to do the same.

Another aspect of the problem is the lack of constant vigil by the Banking Institutions. Most of the times, the viability of the guarantees/Book-debts is lost due to efflux of time and ignorance of the Banks to take required steps in a timely manner. It is important that the Banks should keep a constant watch and observe the changes in viability of any book-debts/guarantees/ receivables which have been hypothecated with the Banks as they are secured assets liable to be enforced under Section 13(4) (d) of SARFAESI Act.

Proceedings under Section 176 of the Indian Contract Act, 1872

If the guarantor has given any pledge of shares held by him, RBI recommends Banks to take immediate steps to sell the pledged shares, under section 176 of the Indian Contract Act, 1872. Section 176 of the Contracts Act, 1872 empowers the Banks to recover the outstanding debt from the personal guarantors as the liability of the personal guarantor is co-extensive with that of the borrower.

Proceedings under RDDBFI Act, 1993

Section 2(g) of the RDDBFI Act defines debt as a liability including interest. Such a liability may be in any form including any court decree and they must be legally recoverable on, the date of the application. As the liabilities of the borrower and the personal guarantor are co-extensive, the debt which is legally recoverable can be recovered from the guarantor as

well. As per Section 17 of the RDDBFI Act the Debt Recovery Tribunal (DRT) is the authority to entertain applications from banks and financial institutions for recovery of debts due to such banks. The said Finance Ministry circular further fixes very high responsibility over the director/promoters of the companies and also outlines the responsibilities of the Banking Institution to file appropriate application before the DRT for attachment and sale of personal properties of the director/promoter under section 19(12) to (18) of the RDDBFI Act, 1993, in case they have not pledged any guarantee before the Banks.

Aim of Study

The author aims to analyse the legal options available to banks to recover the liabilities of the Guarantors during the insolvency proceedings.

Conclusion

After the ruling of the Apex Court in the case of *State Bank of India vs. V Ramakrishan & another*⁵, the moratorium order issued during the CIRP under the I&B Code, 2016 shall not apply to guarantors and hence it will not prevent Banks from taking steps to recover the outstanding amount from the personal guarantor by starting recovery proceedings under SARFAESI Act, 2002, Section 176 of the Contracts Act, 1872 & RDDBFI Act, 1993, depending upon the facts and circumstances of each case.

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