

Interpretation of Moratorium in Insolvency and Bankruptcy Code, 2016: A Dilemma

The Insolvency and Bankruptcy Code (Code) still remains the crucial legislation wherein the industry as well as the law fraternity is still anticipating clarifications on the numerous issues. The moot question of the secured creditors which is repeatedly being posed is whether after the introduction of the Code the security of personal or corporate guarantee is still available as a preferred security for the secured creditors against the Company, against which the Corporate Insolvency Resolution Process (CIRP) has been initiated under the Code.

The aforesaid matter was earlier dealt by the Mumbai bench of NCLT in the case of *Schweitzer Systemic India Private Limited v Phoenix ARC*. The bench while examining the aspect of Moratorium under section 14 of Code held that the 'Moratorium' has no application on the properties beyond the ownership of Corporate Debtor. The opinion and conclusion of the bench was based upon the language used in section 14 (1) (c) of the code which refers "its assets" and denoting the property owned by "Corporate Debtor". The Hon'ble Tribunal in the aforesaid case asserted that as the language mentioned in section 14 (1) (c) is clear there is no possibility even to supply 'casus omissus'. The Tribunal was also of the opinion that the doctrine of 'Noscitur a Sociis', which means that the associated words take their meaning from one another so that common sense meaning coupled together in their cognate sense be interpreted, may be somewhat applicable. The word "its" denotes the property owned by Corporate Debtor. The same view of the Tribunal was upheld by the Hon'ble National Company Law Appellate Tribunal (NCLAT) vide its order dated 31.07.2017 in of *Alpha & Omega Diagnostics v Asset Reconstruction of Company India Limited*

However, the latest ruling of the National Company Law Appellate Tribunal (Appellate Tribunal) in the case of *State Bank of India (SBI) v VRamakrishnan* and another has evoked another controversy touching upon Code that serves as a major setback to creditors.

In the aforesaid case Mr. V. Ramakrishnan, the Managing Director and promoter of Veesons Energy Systems Limited (Company) gave personal guarantee against the loan secured by the Company from SBI. CIRP was initiated under the Code against the Company and accordingly a moratorium was declared. In accordance with the provisions of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act), SBI invoked the personal guarantee against the personal guarantor and took symbolic possession of the secured assets after issuing notice. The personal guarantor filed an application before the Chennai bench of National Company Law Tribunal, Chennai for staying the proceedings under the SARFAESI Act initiated against him in his capacity of a personal guarantor.

The Chennai Bench of NCLT ruled in favor of the Gurantor and held that the guarantor will substitute the lenders and as a result fresh security interest will be created on the corporate debtor's property. The Tribunal reasoned that creation of such an interest will affect the liability of the borrower and therefore cannot be permitted. The Tribunal placed reliance on sections 14 and 31 of the Code.

The Tribunal also placed its reliance on section 140 of the Indian Contract Act, 1872. Under section 140, where a guarantor has paid the whole or part of the liability which he guaranteed, the guarantor enters into the shoes of his creditor and gets all the rights which he had against the principal debtor. For the aforesaid, the Tribunal allowed the application filed by the personal guarantor and consequently restrained SBI from proceeding against him till the moratorium period is over.

SBI, being aggrieved by the decision of the Tribunal approached the Appellate Tribunal. The Appellate Tribunal concurred with the decision of the Tribunal and ruled that a creditor cannot invoke personal guarantee while the borrower is undergoing CIRP. In other words, the moratorium on sale of assets applies not only to those of corporate debtor but also to the personal guarantors' assets.

It is important to note that the Appellate Tribunal made the following observation in its decision in the case of *Alpha & Omega Diagnostics v Asset Reconstruction of Company India Limited*:

5. However, we are not inclined to accept such submissions as Appellant-Corporate Applicant has sought for "its" own insolvency resolution process that will include only the assets of the Corporate Debtor and not any assets, movable or immovable of a third party, like a director or other. In so far as 'guarantor' is concerned, we are not expressing any opinion, as they come within the meaning of 'Corporate Debtor individually', as distinct from principal debtor who has taken a loan.

The Appellate Tribunal has not referred the findings of *Schweitzer Systemic India Private Limited v Phoenix ARC* or *Alpha & Omega Diagnostics v Asset Reconstruction of Company India Limited* in the case of State Bank of India (SBI) v VRamakrishnan. The Appellate Tribunal in the *the present case of State Bank of India (SBI) v VRamakrishnan* and another concludes by holding:

18. In view of the aforesaid provisions, we hold that the 'Moratorium' will not only be applicable to the property of the 'Corporate Debtor' but also on the 'Personal Guarantor'.

In accordance with the aforesaid judgment, no recovery proceedings can be initiated or continued against the personal guarantors of a Company which is into CIRP however it is important to note that the judgment suggests that rights cannot be exercised against the guarantors only when they affects the liability of the corporate debtor

The present interpretation as adopted by the Hon'ble Appellate Tribunal may lead to further difficulties for the Creditors to recover their dues. This would also lead to personal guarantors(who generally are either promoters or their close relatives) taking undue advantage of the protection provided to them. This may also lead to bankers imposing more strict rules while providing a loan.

The arguments may be placed that subrogation of a guarantor to the position of the creditor does not lead to creation of any fresh encumbrance on the assets of the borrower as it is more of a replacement of the encumbrance from the side of lender to the guarantor.

Though the matter can still be appealed in Supreme Court and the clarity can be brought in by the Supreme Court where there are contradictory judgments by the same appellate tribunal. Further the committee working on review of the Code may also suggest changes to this important issue.