



## ERGO

*Analysing developments impacting business*

### AMBIT OF THE INSOLVENCY AND BANKRUPTCY CODE EXPANDED TO INCLUDE PERSONAL GUARANTORS

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#### INTRODUCTION

Various Indian judicial fora, including the Supreme Court, have affirmed that a creditor may proceed against a guarantor on failure of the principal debtor to repay a loan without first exhausting his remedies against the principal debtor.

Thus far, the Insolvency and Bankruptcy Code, 2016 ("Code") had covered only insolvency resolution and liquidation of corporate debtors. The provisions of the Code concerning insolvency resolution and bankruptcy of personal guarantors to corporate debtors had been left out. Keeping in view the need to have a comprehensive and streamlined insolvency resolution and bankruptcy process, the Central Government has recently notified *inter alia* Sections 78 (except with regard to fresh start process), 79, 94 to 187 of the Code and two pairs of connected rules and regulations viz. the Insolvency and Bankruptcy (Application to Adjudicating Authority for Insolvency Resolution Process for Personal Guarantors to Corporate Debtors) Rules, 2019 ("Insolvency Resolution Rules") and the IBBI (Insolvency Resolution Process for Personal Guarantors to Corporate Debtors) Regulations, 2019 ("Insolvency Resolution Regulations"); Insolvency and Bankruptcy (Application to Adjudicating Authority for Bankruptcy Process for Personal Guarantors to Corporate Debtors) Rules, 2019 ("Bankruptcy Rules") and the IBBI (Bankruptcy Process for Personal Guarantors to Corporate Debtors) Regulations, 2019 ("Bankruptcy Regulations"), with effect from 1 December 2019. With this, personal guarantors of corporate debtors have been brought within the ambit of the Code.

In this Ergo, we aim to highlight the key provisions in relation to the insolvency resolution process applicable to personal guarantors of a corporate debtor. A separate Ergo on the bankruptcy process applicable to personal guarantors of a corporate debtor shall be circulated shortly.

#### Meaning of 'Guarantor'

Under both the Insolvency Resolution Rules and the Bankruptcy Rules, a 'guarantor' is defined as "*a debtor who is a personal guarantor to a corporate debtor and in respect of whom guarantee has been invoked by the creditor and remains unpaid in full or part*". The Code specifies that to initiate insolvency resolution in respect of individuals, such as personal guarantors to a corporate debtor, the amount of default should be at least INR 1,000.

#### Adjudicating Authority

Under Section 79(1) of the Code, the Debt Recovery Tribunal has been named as the Adjudicating Authority for insolvency resolution and bankruptcy of individuals. However, Section 60 of the Code provides that in the event there is any insolvency

resolution/liquidation proceedings against a corporate debtor pending before an NCLT, the insolvency resolution/bankruptcy proceedings against a personal guarantor of such corporate debtor must also be filed before the same NCLT. Further, if there are any pending insolvency resolution or liquidation proceedings against a personal guarantor before any court or tribunal, the same are to be transferred to the relevant NCLT.

#### **Filing of Application**

Sections 94 and 95 of the Code provide that an application for insolvency resolution of a personal guarantor may be filed by the personal guarantor himself or by a creditor or by a resolution professional on behalf of either the personal guarantor or the creditor. Where the creditor desires to initiate insolvency resolution proceedings against a personal guarantor, the creditor is first required to issue notice calling upon the personal guarantor to make payment of the entire debt within 14 days of receipt of such notice. In the event, the personal guarantor fails to make such payment within the stipulated time period, the creditor is entitled to file an application for initiation of insolvency resolution.

#### **Interim Moratorium and Appointment of Resolution Professional**

Section 96 of the Code provides that when an application is filed under Section 94 or Section 95, an interim moratorium period commences. During this period, every legal action or proceeding pending in respect of any debt owed by the personal guarantor shall be deemed to have been stayed and the creditors of the personal guarantor shall not be entitled to initiate any legal action or proceedings in respect of any debt.

Where an application is filed under Section 94 or 95 through a resolution professional, the Adjudicating Authority is required to, within 7 days of the filing of such application, direct the IBBI to confirm that there are no disciplinary proceedings pending against such resolution professional, subsequent to which the IBBI confirms/rejects the appointment of the resolution professional. Where an application is filed by the debtor or the creditor himself, the Adjudicating Authority is required to, within 7 days of the filing of such application, direct the IBBI to nominate a resolution professional.

Such resolution professional is then required to examine the application and prepare a report recommending approval or rejection of such application, within 10 days of his appointment. Interestingly, the Insolvency Resolution Regulations provide that an insolvency professional is ineligible to act as the resolution professional of the personal guarantor, if he is already acting/has acted as an interim resolution professional/resolution professional/liquidator of the corporate debtor in respect of whom the personal guarantor has furnished a guarantee.

Subsequently, the Adjudicating Authority is required to take into account the recommendations of the resolution professional so appointed, and either admit or reject the application so filed, within 14 days from the date of submission of the report by the resolution professional.

#### **Moratorium**

Section 101 of the Code provides that on admission of the application, the interim moratorium ceases to have effect and the period of moratorium commences. Significantly, apart from the restrictions detailed above that are applicable during the period of interim moratorium, the Code additionally restricts and prevents the personal guarantor from transferring, alienating, encumbering or disposing of any of his assets or legal rights or beneficial interests therein, during the period of moratorium. Such period of moratorium lasts till the date the Adjudicating Authority passes an order approving or rejecting the repayment plan, and in any case before the expiry of 180 days beginning with the date of admission.

Within 7 days of the order admitting the application, the Adjudicating Authority is required to issue a public notice inviting claims from the creditors of such personal guarantor, within 21 days of issuance of such public notice. The resolution professional is further required to prepare a list of creditors in accordance with Section 104 of the Code. Whilst the creditors meet and vote on the repayment plan, there is no concept

of a committee of creditors. Also, there is no differentiation between operational and financial creditors.

### **Repayment Plan**

The debtor is required to prepare a repayment plan in consultation with the resolution professional. According to the Insolvency Resolution Regulations, the repayment plan must, *inter alia*, provide the term of the repayment plan and its implementation schedule as well as the source of funds. The repayment plan may also provide for transfer or sale of all or part of the assets of the guarantor along with the mode and manner of such sale, satisfaction or modification of any security interest, reduction in amount payable to creditors and modification as to the terms of repayment, etc. Significantly, the repayment plan must also provide for a minimum budget required for the personal guarantor to cover his reasonable expenses and also of his immediate family members to the extent they are dependent on him, provided that at the very least, 10% of the realisable income of the personal guarantor is used for repayment of his debts.

The resolution professional is required to submit to the Adjudicating Authority the repayment plan along with his report on such plan within 21 days from the last day of submission of claims by creditors pursuant to the public notice. It must be borne out from the report of the resolution professional that the repayment plan is in compliance with any provisions of law for the time being in force; has a reasonable prospect of being approved and implemented; and also if there is any necessity of convening a meeting of creditors to consider such a plan. If the resolution professional is of the view that a meeting of creditors is not required, he should provide reasons for the same.

### **Meeting of Creditors**

The Insolvency Resolution Regulations provide that in the event the creditors having 33% of the voting share (which shall be in proportion to the debt owed by the personal guarantor to such creditor) make a request for convening a meeting of the creditors, the resolution professional is required to convene such a meeting. Furthermore, any decision taken by the creditors requires approval of more than fifty percent of voting share of the creditors who vote, unless otherwise specified in the Code.

In a situation where a meeting of creditors is to be convened, Section 107 of the Code provides that the resolution professional is required to give the creditors at least 14 days' notice of such meeting along with copies of the repayment plan, statement of affairs of the debtor, report of the resolution professional and forms for proxy voting. The Insolvency Resolution Regulations prescribe that the statement of affairs of the guarantor shall include details such as: assets and liabilities and income statement for the preceding three financial years and current financial year; details of the excluded assets and excluded debts; income tax returns filed in the preceding three financial years, amount due to each creditor, segregated into secured and unsecured debts, for the preceding three financial years etc.

At the meeting of the creditors, the creditors may decide to approve, modify or reject the repayment plan. Any modifications suggested by the creditors may be made only with the consent of the debtor. The resolution professional is also empowered to adjourn the meeting, for sufficient cause, for a period of not more than 7 days at a time. In terms of Section 111 of the Code, the repayment plan or any modification thereto is required to be approved by a majority of more than three-fourth in value of the creditors present in person or by proxy and voting on the resolution i.e. by 75% value of the creditors. This threshold is higher than the 66% threshold in case of approval of a resolution plan of a corporate debtor.

### **Certain Assets not to be Part of the Insolvency Resolution Process**

It is pertinent to note that sub-section 14 of Section 79 of the Code defines "excluded assets" in so far as personal insolvency resolution is concerned. The Insolvency Resolution Rules further crystallise the scope of "excluded assets" in respect of personal guarantors by stipulating that the value of unencumbered personal ornaments shall not exceed INR 1,00,000 and the value of unencumbered single dwelling unit owned by the

guarantor shall not exceed INR 20,00,000 when such dwelling unit is in an urban area and INR 10,00,000 when it is in a rural area. Excluded Assets do not form a part of the insolvency resolution process.

#### **Approval or Rejection of the Repayment Plan by the Adjudicating Authority**

In terms of Section 112 of the Code, the resolution professional is also required to prepare a report of the meeting of creditors on the repayment plan. The same is required to be provided to the debtor, creditors and the Adjudicating Authority. Section 114 provides that the Adjudicating Authority shall, by an order, approve or reject the repayment plan on the basis of the report submitted by the resolution professional, on the outcome of the meeting of creditors. If a meeting of creditors is not held, the Adjudicating Authority is required to pass an order on the basis of the report prepared by the resolution professional (at the time of submitting the report on the repayment plan to the Adjudicating Authority).

The order of the Adjudicating Authority approving the repayment plan may also provide necessary directions for implementation thereof. If the Adjudicating Authority is of the opinion that the repayment plan requires modification, it may direct the resolution professional to re-convene a meeting of creditors for reconsidering the repayment plan. The provisions of the Code however do not provide the parameters which the Adjudicating Authority has to keep in mind whilst accepting or rejecting a repayment plan.

#### **Effect of Approval/Non-Approval of the Repayment Plan**

Once the repayment plan has been approved, the same shall take effect as if proposed by the debtor in the meeting and be binding on the creditors mentioned in the repayment plan and the debtor. The resolution professional is required to supervise the implementation of the repayment plan. He is also free to apply to the Adjudicating Authority for directions, if necessary. Further, the resolution professional is required to, within 14 days of the completion of the repayment plan, forward a notice to the persons who are bound thereunder to the effect that the repayment plan has been fully implemented, and a copy of the report summarizing all receipts and payments made pursuant thereto.

If the repayment plan is rejected by the Adjudicating Authority, the debtor and the creditors are entitled to file an application for bankruptcy of the debtor. However, unlike the liquidation of a corporate debtor, bankruptcy of a personal guarantor is not compulsory or automatic.

#### **Non-Cooperation by the Personal Guarantor**

The resolution professional has also been empowered to prepare a statement detailing non-cooperation of the guarantor at any time during the resolution process, including implementation of the repayment plan, and submit the same to the Adjudicating Authority for directions.

#### **Premature End to the Repayment Plan**

Section 118 of the Code contemplates that a repayment plan shall be deemed to have come to an end prematurely if it has not been fully implemented in respect of all persons bound by it, within the period mentioned in the repayment plan. In such cases, the resolution professional is required to submit a report on the same and the Adjudicating Authority may on the basis of such report hold that the repayment plan has not been completely implemented. In case the Adjudicating Authority closes the resolution process, the debtor on his own or the creditors whose claims under the repayment plan have not yet been fully satisfied, may apply for a bankruptcy order.

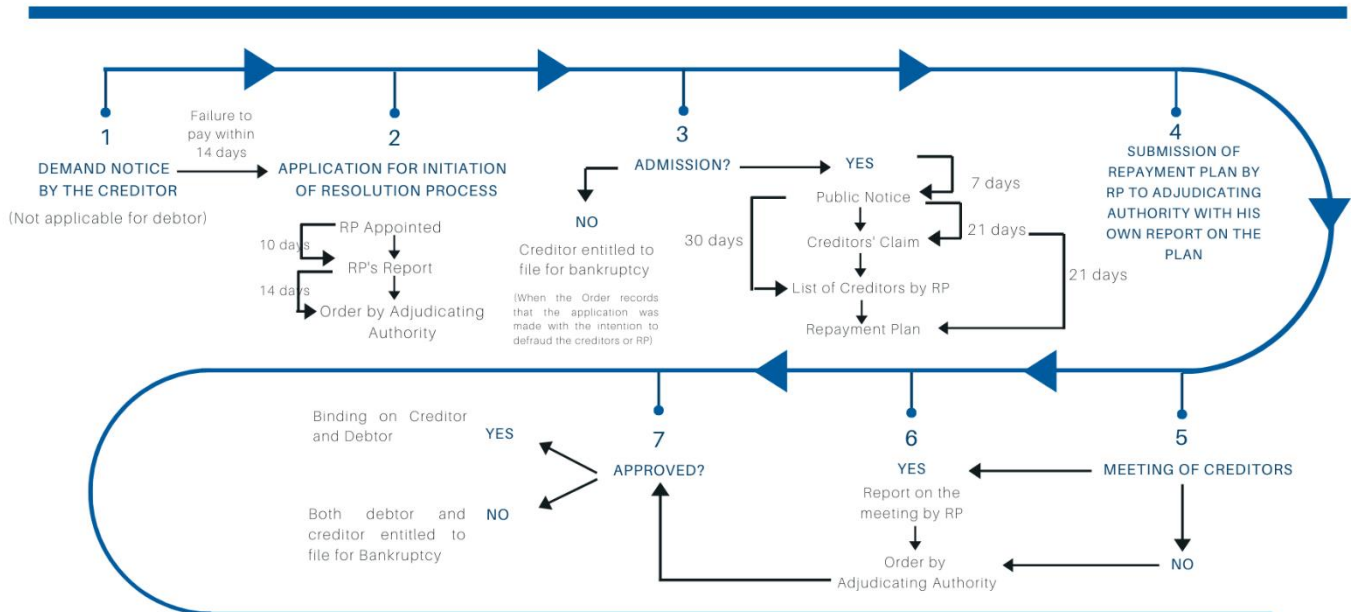
Subsequently, the resolution professional shall apply to the Adjudicating Authority for a discharge order. The repayment plan may provide for an early discharge or discharge on complete implementation of the repayment plan. Further, the discharge order shall not discharge any other person from any liability in respect of his debt.

**Comment**

As seen from above, the Central Government has finally brought into effect provisions of the Code relating to personal guarantors. These provisions would no doubt go a long way in ensuring that a speedy and efficacious resolution is available in matters relating to defaults of loans secured by personal guarantors. Of course the proof of the pudding is in the eating and the Government may be required to iron out teething issues in the resolution process as and when they arise.

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**The Process**



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