

Law Relating to Insolvency of Personal Guarantors to Corporate Debtor

The Ministry of Corporate Affairs (“MCA”) vide notification no. S.O. 4126 (E), dated November 15, 2019 (“MCA Notification”), made IBC provisions relating to personal insolvency applicable, only in so far as relating to Personal Guarantors to Corporate Debtor (PG to CD) effective from December 1, 2019. After the publication of the MCA Notification, many demand notices were served to initiate insolvency proceedings under the IBC. This led to initiation of insolvency proceedings against promoters, directors of various companies, including Reliance Group’s Anil Ambani, Dewan Housing Finance Corporation Ltd.’s Kapil Wadhawan under Part III of the IBC. The said MCA Notification got challenged before various High Courts across the country. To avoid conflicting decisions by various High Courts, the Hon’ble Supreme Court, in October 2020, directed that all the writ petitions pending in the High Courts be transferred to the Supreme Court.

While adjudicating finally, the Supreme Court of India in *Lalit Kumar Jain vs Union of India & Ors.* (2021) ibclaw.in 61 SC (“Lalit Kumar Judgment”) vide its judgement dated May 21, 2021 upheld the validity of MCA Notification, which brought the provisions relating to Personal Guarantors to Corporate Debtors into force with effect from December 1, 2019

Chapter III to Chapter VII comprising section 94 to 187 of IBC 2016 deals with personal insolvency. Presently, section 94 to 187 of IBC 2016, have been made effective for Personal Guarantors to Corporate Debtor (PG to CD) only and the Adjudicating Authority for the same is NCLT having jurisdiction over the Corporate Debtor. Application for PG to CD can be filed both by debtor and creditor under section 94 & section 95 respectively, either personally or through a Resolution Professional (RP) in both the cases with a fee of Rs. 2,000/-. No threshold limit has been prescribed for initiating PG to CD unlike threshold limit of Rs 100 lacs for initiation of corporate insolvency (CIRP), but the same may be treated as threshold limit as CIRP cannot be initiated below the threshold limit of Rs. 100 lacs.

Unlike Corporate insolvency where moratorium starts on acceptance of application for initiation CIRP by Hon’ble NCLT but in personal insolvency, moratorium starts immediately on filing of application u/s 94 or 95 of IBC 2016.

IBC 2016 deals, personal insolvency in four stages:

- (a) Pre-Application Stage
- (b) Admission Stage.
- (c) Insolvency Resolution Process Stage.
- (d) Bankruptcy Stage

(a) Pre-Application Stage:

- Appointment of RP is must, if the application is to be filed through RP, otherwise the AA shall appoint RP u/s 97.
- Application u/s 94 in Form A may be filed by debtor if (i) debt is in default & remains unpaid, (ii) debt is not an excluded debts, (iii) debtor is not an undischarged bankrupt, (iv) debtor is not undergoing fresh start process, (v) debtor is not undergoing an insolvency resolution process, (vi) debtor is not undergoing bankruptcy process, and (vii) no application of the debtor has been admitted during the period of twelve months preceding the date of submission of application u/s 94, and
- Application u/s 95 in Form C may be filed by creditor(s) if (i) debt owed by debtor to the creditor and the same is in default, (ii) demand notice has been served to the debtor and debt has not been paid within a period of fourteen days of the service of notice of demand & (iii) relevant evidence of such default or non-payment of debt,

(b) Admission Stage:

- Service of Application – (i) Debtor to serve a copy of application to every financial creditor, the Corporate Debtor for whom the Guarantor is a Personal Guarantor and the Board and (ii) Creditor to serve a copy of application to the Debtor, Corporate Debtor for whom the Guarantor is a Personal Guarantor and the Board.
- RP is required to examine the application and submit his report to AA u/s 99 with 10 days from the date of his appointment u/s 97, recommending admission or rejection of application.
- While examination of application, the RP may satisfy himself that default has occurred, debt is not an excluded debt, demand notice has been issued by the creditor and the amount of demand notice remains unpaid in full or part.
- On filing of report by Resolution Professional u/s 99, the Hon'ble NCLT shall either admit or reject the application u/s 100 of IBC 2016. Insolvency Resolution Process against PG to CD commences with the admission of application. If application is rejected then interim moratorium comes to an end otherwise moratorium continues.

(c) Insolvency Resolution Process Stage.

Insolvency Resolution Process for PG to CD is quite different than CIRP. In personal insolvency of PG to CD, there is no requirement of preparing Information Memorandum, appointment of valuer(s), filing of avoidable transaction application, publication of Form "G", submission of EOI and Resolution Plan. Unlike CIRP, the control of assets of the Debtor remains with the debtor only. In personal insolvency, the onus is on debtor to prepare a Repayment Plan containing a proposal to the creditors for his debt or affairs. Role of RP is to facilitate the Debtor in preparing the Repayment Plan. As per section 106 of the Code, RP is required to submit his report within twenty one days from the last date of submission of claims, stating whether Repayment Plan received from debtor is in compliance with the Code and Repayment Plan has a reasonable prospect of being approved and implemented. Only after submitting such report, Resolution Professional can summon meeting of creditors within not less than fourteen days and not more than twenty eight days from the date of submission of his Report to AA to consider Repayment Plan by the Creditors.

An associate of debtor is not entitled to vote on Repayment Plan. Further, secured creditors participating in the meeting and voting, is required to forfeit its right to enforce security interest during period of repayment. In case, creditor has provided both secured and unsecured debt, then secured creditor to extent of unsecured debt only can exercise voting right without losing its right to enforce security interest for the secured debt.

The Creditors may decide to approve, modify or reject the Repayment Plan. However, modification suggested by creditors, if any, shall be required to be consented by the Debtor. Approval of Repayment Plan requires three-fourth voting (in value terms) unlike 66% voting in CIRP, in favour by value of the creditors present in person and voting. One important difference between CIRP and personal insolvency is, while in CIRP, affirmative vote of minimum 66% of total vote is required for approval of a Resolution Plan, but in personal insolvency, approval of Repayment Plan requires **three fourth vote share, which is present and voting.**

The copy of report of the Meeting (Minutes of the Meeting) needs to be provided to (a) Debtor, (b) the Creditors, including those who were not present at the meeting and (c) the Adjudicating Authority.

Thereafter, Adjudicating Authority passes order u/s 114 on Repayment Plan. Adjudicating Authority approving the Repayment Plan may also provide directions for implementation of the Repayment Plan.

The RP shall supervise the implementation of Repayment Plan. On completion of Repayment Plan and compliance with respect thereto, RP is required to apply to Adjudicating Authority u/s 119 for issuance of discharge order in relation to the debts mentioned in the Repayment Plan and upon issuance of such discharge order, debtor discharges from debt mentioned in Repayment Plan.

Effect of Adjudicating Authority Order

Under the following circumstances Individual Insolvency Resolution Process comes to an end:

- a) If Adjudicating Authority passes an order u/s 100 for rejecting the application filed u/s 94 or 95
- b) The Debtor fails to submit the Repayment Plan,
- c) Repayment Plan submitted by the Debtor is not accepted by the creditors
- d) Repayment Plan approved by the Creditors is rejected by the Adjudicating Authority

(d) Bankruptcy Stage

An Application can be filed within a period of three months by the Debtor or by Creditor(s) to Adjudicating Authority u/s 121 of the Code for Bankruptcy of the debtor (PG to CD) on passing of following orders by Adjudicating Authority:-

- a) Under section 100(4) for rejecting application for initiation of Insolvency Resolution Process, or
- b) Under section 115(2) for rejecting the Repayment Plan , or
- c) Under section 118(3) confirming that Repayment Plan has not been completely implemented.

The Debtor or Creditor may propose the name of an Insolvency Professional as the Bankruptcy Trustee. Interim moratorium commences on the date of filing of application u/s 121. On approval of application filed, Adjudicating Authority appoints an Insolvency Professional proposed in the application otherwise any other Insolvency Professional as Bankruptcy Trustee, who conducts the administration and distribution of the estate of the Bankrupt. On realisation and distribution of estate, Bankruptcy Trustee apply to Adjudicating Authority for issuance of discharge order. Issue of discharge order u/s 138 releases the Bankrupt from all bankruptcy debt.

Difference between discharge orders issued u/s 119 (on completion of Repayment Plan) and u/s 138 (i.e. on completion of distribution of estate of bankrupt by Bankruptcy Trustee)

On issue of discharge order, individual (PG to CD) discharges from debts mentioned in Repayment Plan and incur no disqualification. However, discharge order issued u/s 138, discharges bankrupt from all debt but incur disqualification mentioned in section 140 for a period of one year from bankruptcy commencement date.

Distribution of estate

No water fall mechanism or priority in payment, as in the case of CIRP or liquidation (refer section 53) has been provided in personal insolvency and therefore, except secured creditors, who have a right to crystallise their security interest, all others creditors are generally paid in the ratio of their admitted claim in personal insolvency.

Effectiveness of personal insolvency

Role of Resolution Professional (except during bankruptcy stage) is to facilitate debtor in submitting Repayment Plan and preparing claim list only. Therefore, Repayment Plan remains on the whims & fancy of debtor only. Resolution Professional neither have adequate means nor authority to trace out assets transferred / disposed off by debtor. Therefore, creditors' realisation in most of the cases is upto the value of assets on which they have security interest and any other asset disclosed by the debtor. However, personal insolvency is helpful in resolving cases where sale of assets owned by a debtor is difficult due to multiplicity of encumbrances, joint ownership etc. Though, initiation of personal insolvency may have limited effect on realisation of lenders but social stigma of personal insolvency is a great deterrent effect which compel debtor to come on negotiating table.

Present status of personal insolvency

Though banks have filed large number of applications for initiation of Insolvency Resolution Process for PG to CD and in many cases, Hon'ble NCLT has passed order u/s 100 for admitting such applications. However, only in very few cases, debtors have submitted Repayment Plan. There is hardly few cases where banks have filed application u/s 121 for initiation of bankruptcy proceedings

due to non-submission / rejection of Repayment Plan. There is no case so far wherein Hon'ble Adjudicating Authority has issued discharge order u/s 138 of the Code.

Personal Guarantors has challenged constitutional validity of personal insolvency provisions of IBC 2016 before the Supreme Court. Apex Court has granted stay and issued notice on a petition filed by personal guarantors. Since the similar issue is pending, the Apex Court has directed tagging of other such cases being filed before it. Supreme Court stay on a personal guarantor case is likely to be used across the country in all PG to CD cases pending before various National Company Law Tribunals.

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