



## IMPLICATIONS OF THE INSOLVENCY RESOLUTION AGAINST PERSONAL GUARANTORS

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### 1. Introduction

The Insolvency and Bankruptcy Code, 2016 ("IBC") was enacted with a view to weed out the archaic insolvency laws and to facilitate quick insolvency resolution processes. The IBC has undergone myriad changes since it commenced in 2016. It is a dynamic law, which has evolved as per the changing needs of the society. One of the most recent changes in the IBC is its extension to personal guarantors of corporate debtors. IBC, till now only applied to corporate debtors. However, from December 1, 2019, it is also applicable to personal guarantors of these corporate debtors. On November 15, 2019, 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") were notified. Provisions of IBC which related to insolvency resolution of personal guarantors were also brought into effect. Through this article, we shall analyse the implications of the insolvency resolution processes of personal guarantors to corporate debtors.

### Insolvency Resolution Process of Personal Guarantors

#### a) Applicability

Before we set out to discuss the insolvency resolution process, it is pertinent to discuss to whom is this process applicable to. Personal guarantors under the IBC are defined as, personal guarantors to corporate debtors against whom guarantee has been invoked by the creditor and the debt regarding which such guarantee has been invoked, remains unpaid in full or part.

#### b) How is the insolvency process commenced?

An application to initiate the insolvency process can be filed by the guarantor himself or by the creditors, either singly or jointly. When the application for insolvency is filed by the creditors, then a document which evidences that a demand for repayment was made, but not honoured, has to be given along with the application.

#### c) Interim Moratorium

A moratorium means a stay on all pending legal proceedings while the insolvency resolution process is going on. For the purposes of insolvency



resolution of personal guarantors, the concept of an interim moratorium has been introduced. Such interim moratorium starts when applications for insolvency resolution are filed and automatically ends when these applications are admitted. Please note, that the concept of interim moratorium is only applicable to insolvency resolution of personal guarantors and not the original corporate debtors.

**d) Process of Admitting/Rejecting an application for insolvency**

After the filing of the insolvency application, the adjudicating authority calls upon the Insolvency and Bankruptcy Board of India, to nominate a Resolution Professional (“RP”). The RP is appointed by the adjudicating authority to assess the insolvency application on its merits. The RP after careful examination, submits a report to the adjudicating authority wherein he suggests, either admission or rejection of the application. The adjudicating authority is required to take this report into consideration and consequently pass orders either admitting or rejecting the application. If it is found that the insolvency application has been filed by the guarantor with an intention to defraud the creditors and it is rejected on this ground, the creditors can file for bankruptcy.

**e) Moratorium**

Insolvency of personal guarantors has two types of moratoriums: interim and regular. The interim moratorium ceases upon the admission of the insolvency application. When the insolvency application is admitted, the regular moratorium starts with regard to all the debts of the personal guarantor. Such a moratorium remains in effect till orders are passed with respect to the repayment plan or till 180 days have passed, whichever is earlier in time.

**Claims by Creditors**

Once the application is admitted, the adjudicating authority issues a public notice. Such notice calls upon the creditors to present their claims within 21 days of the issuance of such notice. Claims can be sent through electronic means, courier, speed post or registered letter. A list of creditors is prepared post the receipt of claims by the resolution professional.

**Repayment Plan**

The repayment plan is the key to this entire process. It is the same as a resolution plan. The resolution professional along with the guarantor prepare a repayment plan. Such plan typically contains proposals for restructuring the debts of the guarantor. The resolution professional is required to evaluate and assess this plan and prepare a report on the same. He is then required to submit this report along with the repayment plan to the adjudicating authority. The report contains suggestions from the resolution professional including, whether



a meeting of creditors is required or not. If a creditors' meeting is required, then the resolution professional needs to send a notice to the creditors of such a meeting along with a copy of the repayment plan.

#### f) Meeting of Creditors

Once, the plan is presented to the adjudicating authority, the meeting of creditors takes place to accept, reject or alter the repayment plan. Each creditor has a vote share in proportion to the debt which is owed to them. One very crucial feature regarding the personal guarantor insolvency resolution is that the modification of the plan is subject to the guarantor's consent. Hence, in effect the guarantor has a veto over modification of the plan. A secured creditor is also allowed to vote, if he/she dispenses off with their right to enforce their security. The repayment plan or any alteration to the same is required to be approved by a majority of more than three-fourth in value of the creditors who are present either in person or through proxy and are voting.

#### g) Approval by Adjudicating Authority

The decisions taken at the meeting of creditors are required to be tabulated into a report by the resolution professional and presented to the adjudicating authority. The Adjudicating Authority can either accept, reject or change the plan and send it back to the creditors for a reconsideration. The Adjudicating Authority's decision in this regard is considered final. In the event the repayment plan is rejected by the adjudicating authority, the creditors and/or the guarantor, may file an application for bankruptcy.

### Implications of the Changes

The following implications of the changes brought about may be noted:

- a) Further reduction in NPAs: Since the inception of the IBC, it has contributed immensely towards reduction in NPAs. The gross NPA ratio has reduced from 7.5% to -8.0% from March 2016 to March 2020. Similarly, the accretion of fresh NPAs has also reduced 6% to -3.2% in the aforementioned 4 years<sup>1</sup>. The introduction of personal guarantor insolvency, will open one more avenue, through which creditors can realize their loans. Hence, the notification of the provisions pertaining to personal guarantor insolvency shall lead to further reduction in NPAs.

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<sup>1</sup><https://www.crisil.com/content/dam/crisil/pr/press-release/2017/12/bank-npas-to-shrink-350-bps-to-~8per-by-march-2020.pdf>, date accessed January 20, 2020



- b) One important feature of this insolvency resolution process is that a corporate debtor resolution and a personal guarantor insolvency resolution can proceed parallel to each other. This provides a creditor with more options and leads to lesser delay.
- c) The personal insolvency resolution process, introduces the concept of interim moratorium. Such moratorium starts even before an insolvency application is admitted. This prevents pre-mature disposal of assets to avoid paying back of loans.
- d) The RP has been endowed with important powers under the insolvency regime of personal guarantors. A meeting of creditors is solely dependant upon the RP's objective assessment. The creditors do not have a say in the same. Moreover, there is no requirement for the plan to be just, fair and equitable.
- e) Guarantors' power to consent to the modification of the plan may have been ill-thought of. This can lead to considerable delays and place a large amount of power in the hands of the guarantor.
- f) All the creditors- financial and operational can sit in the creditors' meeting and vote, unlike the corporate debtor's insolvency resolution process.

## Conclusion

The beginning of the insolvency regime for personal guarantors will make it difficult for individuals to act as personal guarantors. The provision of parallel proceedings against the corporate debtor and the personal guarantors provide more alternatives to the creditors. This also prevents personal guarantors from evading repayment. It may also be noted, that the entire process is extremely centered around the resolution professional. He has been given significant powers. The fact that all creditors can vote in a meeting of creditors and there is no difference between financial creditors and operational creditors, may impel the operational creditors to resort to initiation of insolvency proceedings against personal guarantors. Some areas which the insolvency regime for personal guarantors does not touch upon are the priority of payments and distribution of debts. Moreover, the law does not talk about situations, where bankruptcy is initiated due to the rejection of repayment plan of personal guarantor but the resolution plan of the corporate debtor is accepted. Though, the process is not completely error-free and leaves room for speculation, it is a welcome step towards ensuring creditor security through IBC.