

Invocation of Bank Guarantees during Moratorium: Tale of Conflicting Decisions

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Introduction

Bank guarantee represents an independent contract between the bank and beneficiary, and it is considered as a standard mode of securing payment of money in commercial dealings. The beneficiary is entitled to claim the whole of the amount under guarantee irrespective of any pending legal dispute between the concerned parties. Thus, the invocation is utterly dependent on the terms of the guarantee, but the conflict arises when third party guarantees are enforced during the moratorium period of a corporate debtor in relation to which a CIRP has been initiated.

[Section 13](#) of the Code states that the adjudicating authority (NCLT), after accepting application under Section 7 or Section 9 or Section 10, declare a moratorium under Section 14. [Section 14](#) makes it amply clear that during the continuance of moratorium period, there shall be no action whatsoever of enforcement, foreclosure or recovery of any 'security interest' which has been created by the corporate debtor towards its property. Also, any transfer, alienation, encumbrance or disposal of the assets or beneficial interests or any legal right by the corporate debtor during the [moratorium](#) is prohibited.

The definition of the security interest as defined under [Section 3\(31\)](#) of the Code excludes performance guarantee, and thus the intent of the legislature is clear. Still, the conflicting decision of various adjudicating bodies has led to a trail of complexities and ambiguities. This article aims to shed some light on the same by analyzing the contradictory case laws on differential treatment of bank guarantee during the moratorium period and evaluate whether a Non-Performance Bank Guarantee (NPBG) deserves a different treatment from Performance Bank Guarantees (PBG) regarding its invocation during the moratorium period.

Conflicting Decisions Regarding Invocation of Bank Guarantees

The definition of '[security interest](#)' under the Code includes an interest that has been created in favor of a secured creditor by a transaction which secures payment or performance of an obligation. However, despite including performance obligations within the ambit of security interest, the Legislature decided to exclude performance-based guarantees from the definition. The intent of the Legislature that leads to the inclusion of performance obligations under the definition but at the same time excludes performance guarantees from the ambit of security interest gives rise to a conundrum when the same is put to test by the concerned NCLT(s).

Section 3(31) explicitly states that security interest shall not include a performance guarantee, and a similar view was adopted in the recent case of *Indian Overseas Bank v. Arvind Kumar* ([2020 ibclaw.in 285 NCLAT](#)) where bank guarantee was invoked during the period of the moratorium, and margin money was utilized for payment of Bank guarantee amount; thus the resolution professional objected to this. Appellant while justifying the invocation of bank guarantee relied on the decision of NCLAT in the case of *Gail (India) Limited v. Rajeev Manaadiar* ([2018 ibclaw.in 43 NCLAT](#)) where it was

held that "*Moratorium order will not be applicable on the Performance Bank Guarantee given the fact that definition of the 'security interest' under Section 3(31) Code explicitly excludes Performance Bank Guarantee from the purview of security interest.*" The Tribunal while accepting the contention of the appellant, held that IRP is only entitled to those payments to which the debtor is entitled if no orders of Moratorium had been issued according to the provisions of the Code. Thus the corporate debtor had no right to claim the margin money once the bank guarantee is invoked.

Thus the take of NCLAT in the present matter made it clear that the Performance Bank Guarantee is not covered under Section 14 of the Code. Therefore, the invocation of bank guarantee during the moratorium period is justifiable. But the contradictory view was expressed in the case of [ICICI Bank Ltd. v. Vista Steel Pvt. Ltd.](#), where the invocation of bank guarantee was stayed owing to the fact that the moratorium period was under operation.

The issue regarding the invocation of bank guarantee during moratorium period arose for the first time in the case of [ABG Shipyard Limited v. Government of India & Ors](#), where a writ petition was moved by a resolution professional of a corporate debtor who was seeking an injunction against the invocation of bank guarantee issued on behalf of a debtor during CIRP. The main issue before the Court was whether bank guarantee could be invoked pursuant to an order of admission of CIRP by the Tribunal and during the Moratorium period?

The Hon'ble Court while restraining the invocation of bank guarantee in question held that "*though the Court abstains from interfering with matters pertaining to invocation of the bank guarantee or the performance guarantee as it has been settled law that the Court should not interfere with the matters of invocation of the bank guarantee except on limited grounds. However, the law declared and observation made has reference to ordinary commercial transaction and performance guarantee. In the facts of the present case, the application of the Insolvency and Bankruptcy Code, 2016 have to be considered, which provides for a separate procedure in case of such company, which is under resolution process.*"

Similarly, in the case of *Corporation Bank v. Amtek Auto Limited* ([2019 ibclaw.in 14 NCLT](#)) it was observed that *once the moratorium is declared, financial institutions have to act "on the instructions of resolution professional with respect to the corporate debtors' account and consequently corporate guarantees could not be invoked as the same would violate the moratorium provided to a company undergoing insolvency resolution and cannot take any action without the approval of resolution professional.* In [another case](#), it was observed that financial creditor could not proceed against the guarantor by invoking the guarantee as same would mean that the interest would now shift on the guarantor and this would, in turn, violate Section 14(1) of the Code.

Though the decision of NCLAT in the case of Indian Overseas Bank set the right precedent by ruling that invocation of performance bank guarantee is not barred during the moratorium period, but the conflicting decisions of other adjudicating bodies make it difficult to bring uniformity regarding enforceability of bank guarantee.

Enforcement of Non-Performance Bank Guarantee

In the definition of Security Interest the legislature intended to exclude PBG from the purview of security interest and thus it suggests that non-performance bank guarantee warrants a different treatment regarding enforceability, but currently there are no provisions in the Code that deal specifically with the invocation of NPBG.

The matter regarding the invocation of NPBG came for the first time in the case of [Berger Paints Ltd. v. Precisions Engineers and Fabricators Pvt. Ltd.](#) where the Tribunal denied invocation of NPBG and ruled that it is apparent that the bank guarantee is invoked after the declaration of the moratorium and consequently no direction can be issued to the resolution professional for reconsideration. A similar matter was witnessed by NCLT, Ahmedabad in the case of [Mr Nitin Hasmukhlal Parikh v. Madhya Gujarat Vij Company Limited & Ors.](#) and it allowed invocation of PBG during the moratorium period. While granting invocation, it referred to the definition of 'security interest', and it was observed that Section 3(31) explicitly states that Performance Guarantees are not included in the security interest. *Therefore, the moratorium order passed by this Tribunal does not apply to the Performance Guarantees given by the Corporate Debtor. The moratorium order passed by this Tribunal applies in respect of Bank Guarantees other than Performance Guarantees furnished by the Corporate Debtor in respect of its property since it comes within the meaning of 'security interest'. Therefore, Respondent is not entitled to invoke Bank Guarantees other than that comes within the meaning of performance Guarantees, during the Moratorium period.*

From the decision above, it is relatively clear that NCLT distinguished performance guarantee from other types of guarantees, by ruling that NPBGs fall within the ambit of 'security interest' and therefore deserved immunity during the moratorium.

In the case of [ICICI Bank Ltd. v. C & C Construction Ltd.](#), the bench restricted invocation of bank guarantee because the moratorium period was under operation, but the decision failed to specify the nature of the bank guarantee. The present position makes it amply clear that predominately various decision support invocation of Performance Bank Guarantee but there is no such ruling about NPBG till date.

The decision of the learned Tribunal in the case of [Mr Nitin Hasmukhlal Parikh v. Madhya Gujarat Company](#) supported a differential treatment for a non-performance bank guarantee. Various tribunals while deciding the matter of invocation of bank guarantee failed to acknowledge the difference between PBG and NPBG and thus at present, there is no clear stand as to the enforcement of NPBG.

Conclusion

Though the decisions of NCLTs about the invocation of bank guarantees create ambiguity, the recent decision of the NCLAT in the case of Indian Overseas Bank stands out because the decision aligns with the intent of the legislature. The legislature by carving out an exception for performance guarantee under Section 3(31) intended invocation of bank guarantee during the moratorium period. It was also observed in the [Insolvency Law Committee Report \(2018\)](#) that *"The assets of the surety are separate from those of the corporate debtor, and proceedings against the corporate debtor may not be seriously impacted by the actions against assets of third parties like sureties."* Thus, contractual principles of a guarantee require being respected even during a moratorium, and an alternate interpretation may not have been the intention of the Code, as is clear from a plain reading of section 14."^[1]

Thus, it can be concluded that though bank guarantees can be treated as security interest created on behalf of the debtor, they cannot be termed as security interest created on behalf of the corporate debtor under Section 14(1) (c). A similar view was adopted in the case of [Haryana Telecom Ltd. and Ors. v. Aluminium Industries Ltd. and Ors.](#), where it was observed that "bank

guarantee cannot be considered as property of the corporate debtor simply because it is indirectly going to be affected by enforcement of the said bank guarantee.”

After the above decision, it becomes pertinent to hold that law as stands today allows invocation of bank guarantee during the moratorium period and bank guarantee cannot be treated as the property of the debtor. Thus it should not get any immunity under Section 14.

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