

**THE NATIONAL COMPANY LAW TRIBUNAL
COURT NO. IV
AT NEW DELHI**

**IA No. 3139/ND/2020
IN
Company Petition No. (IB)-364(ND)/2019**

Under Section 60 (5)(c) of the Insolvency and Bankruptcy Code, 2016

IN THE MATTER OF:

Ms. Rekha Sharma

Resolution Professional of Shri Gnash Fire Equipments Pvt Ltd ...Applicant

Versus

Mr YK Sharma, Sr. Branch Manager

(The National Small Industries Corporation Limited (NSIC), Delhi)

...Respondent No 1

Kaushik Majumdar, Branch Manager

(Canara Bank)

...Respondent No 2

AND IN THE MATTER OF

Jasmeet Associates

...Operational Creditor

Versus

Shri Ganesh Fire Equipments Private Limited

...Corporate Debtor

Order delivered on: 25.08.2021

Coram:

**DR. DEEPTI MUKESH
HON'BLE MEMBER (Judicial)**

**MS. SUMITA PURKAYASTHA
HON'BLE MEMBER (Technical)**

RA/

IA No. 3139/ND/2020

ORDER

Dr. Deepti Mukesh, Hon'ble Member (J)

1. The present application is being filed by RP of the Corporate Debtor aggrieved by non-cooperative and obstructive actions of the Respondent no.1, The National Small Industries Corporation Limited (for brevity NSIC) for violation of moratorium period consequent upon initiation of the CIRP from 06.02.2020 and for issuing necessary directions to the respondent no.1 for illegal action under the provision of IBC, 2016, inter alia seeking following prayers:
 - i. Quash of all the notices as issued by the respondent no. 1;
 - ii. Grant stay on all such invocation of Bank Guarantee / any action to invoke Bank Guarantee.
 - iii. Direct the Respondent to file their claim before RP as financial creditor.
2. National Small Industries Corporation Limited, Respondent No. 1 is a Government Company registered under the Companies Act, which facilitates MSME and also provides integrated support services under Marketing, Technology, Finance and other Support service.
3. The RP submits that on 11.05.2012, the corporate debtor entered in an agreement dated 11.05.2012 with NSIC for raw material financial assistance against bank guarantee under raw material assistance scheme of NSIC. It is submitted that as per clause no. 4 of the agreement, the Corporate Debtor agrees and undertakes to repay the amount with interest @13.4% p.a. or at such other rate as the corporation may charge at its discretion, depending



upon the variation in its lending rates, with a maximum period of 90 days from the date of debit of such amount. In case the payment is not received within the stipulated period, the borrower shall be liable to pay the additional interest @3% p.a. Further, as per clause no. 6 of the agreement, raw material assistance had been provided to the corporate debtor by the corporation subject to furnishing of the Bank Guarantee (BG) in form of security.

The clauses 4 & 6 are reproduced herein:

"4. That the amount(s) advanced, paid or incurred by the Corporation towards remittances for payment of material to the canalised / Government Agencies and ethers for storage, insurance charges, freight for movement of material, Clearance charges, charges for transporting the material, postal expenses and all other charges and expenses incurred by the Corporation in connection with the procurement of the material will be debited to the account of the Borrower and it agrees and undertakes to repay or reimburse the amount(s) so debited to its accounts with interest at the rate of 13.40 percent per annum or at such other rates as the Corporation may charge at its discretion depending upon the variation In its lending rates, within a maximum period of 90 days from the date of debit of such amount(s) . In case the payment Is not received within the stipulated period of 90 days, the Borrower shall be liable to pay additional interest Co 3 percent per annum on the amount(s) of the said advance and processing and administrative charges to the Corporation. The Borrower agrees that such repayment of or reimbursement of the amount debited to its accounts will be made on or before the expiry of 90 days from the data of delivery of the material to the Borrower or date of payment by Corporation whichever is earlier.

6. That the raw material assistance under this Agreement shall be granted by the Corporation to the Borrower subject to furnishing of the following securities by the Borrower: A Bank Guarantees executed by a Nationalized/Approved Bank to the satisfaction of the Corporation. The Corporation shall be entitled to invoke and encash the said Bank Guarantees on the terms and conditions as stipulated in the said Bank Guarantees

That the borrower hereby furnish the Bank Guarantees of the Nationalized Bank covering entire raw material assistance and requested the Corporation to waive the charge over hypothecated good/assets as the same are charged to the Bank. The Corporation has accordingly considered the request of the borrower and waived the creation of charge over the hypothecated good."

4. The RP submits that initially, the raw material financial assistance against BG was sought for Rs. 1.00 Crores and was later increased to Rs. 2.99 Crores by executing a supplementary agreement dated 05.10.2018. That in compliance of the agreement, 7 financial bank guarantees were submitted to NSIC & security interest was created in their favour.
5. In IB 364/ND/2019, an application was filed by an operational creditor M/s Jasmeet Associates for initiating CIRP of corporate debtor Shri Ganesh Fire Equipment's Private Limited, which was admitted appointing Ms. Rekha Sharma as IRP. The public announcement about initiation of CIRP and invitation for submission of claims was made in Business Standard newspapers on 12.02.2020 and till date, NSIC has not submitted any claim form with the RP.
6. The RP submits that NSIC invoked all BGs on 14.02.2020. The actions of NSIC are in violations of the provisions of section 14(1)(c) of I & B Code, 2016 which provides moratorium prohibiting any action to foreclose, recover or enforce any security interest created by the corporate debtor in respect of its property including any action under the SARFESI Act, 2002. The expression security interest has been defined in sub-section 31 of Section 3 of the 'I&B Code', which reads as follows:

'Security interest' means right, title or interest or a claim to property, created in favour of, or provided for a secured creditor by a transaction which secures payment or performance of an obligation and includes mortgage, charge, hypothecation, assignment and encumbrance or any other agreement or arrangement securing payment or performance of any obligation of any person:

Provided that security interest shall not include a performance guarantee.

7. The RP submits that NSIC, vide its letter dated 22.04.2020 addressed to RP has clarified that the BGs as submitted by the Corporate Debtors are only Performance BGs, so moratorium as per section 14 of IBC is not applicable on Performance BGs. Therefore, the RP submits that whether the bank guarantee is in the nature of performance bank guarantee or financial bank guarantee, can be determined by discussing following legal issue:

- i. Raw Material Assistance agreement with NSIC proposing the charge interest @13.4% p.a. and Penal interest @3% p.a. beyond 90 days and processing and administrative charges to the corporation. **(Clause-4 of Agreement)**
- ii. Raw material assistance been provided to the corporate debtor by the NSIC subject to furnishing of the BG in form of security. **(Clause-6 of Agreement)**
- iii. The Main features of the Scheme as displayed on NSIC website is Financial Assistance for procurement of Raw Material upto 90 days. Raw Material Assistance Scheme aims at helping MSMEs by way of financing the purchase of Raw Material. This gives an opportunity to MSMEs to focus better on manufacturing quality products.



8. The RP submits that the above clauses of the agreement and the features of the scheme, categorically evidencing that BGs as submitted by the Corporate Debtor are not Performance BGs but only financial guarantees as they were submitted only for obtaining raw material assistance against bank guarantee and not for securing the performance of providing any goods or services under any contract. The RP submits that in the bank guarantee, there is not a single word of performance bank guarantee rather the word 'bank guarantee', is only used.
9. The RP submits that the rationale behind moratorium being that if a CIRP is going on against the corporate debtor, then the debt owed by the corporate debtor is not final till RP admits all claims and finalizes the total debt, and thus the liability of the surety would also be unclear. It is further submitted that until debt of the corporate debtor is crystallized, the guarantor's liability should not be triggered.
10. The Respondent No. 1, NSIC has filed reply and has asserted as follows:
 - i. That as per the agreement, the corporate debtor agreed to perform certain contractual non-financial obligations. The raw material assistance was granted by NSIC to the corporate debtor on their furnishing a bank guarantee. NSIC was entitled to invoke and encash the said bank guarantees on the terms & conditions as stipulated in the said bank guarantees. NSIC issued 7 irrevocable bank guarantees and these irrevocable bank guarantees were invoked by NSIC vide letter dated 14.02.2020.
 - ii. That Respondent No 2, Canara Bank withheld payment of bank guarantees on

account of admission of the corporate debtor under CIRP. That irrespective of nature of the Bank Guarantees, Section 14 (3) (b) of IBC, 2016 provides for non-applicability of section 14(1), meaning thereof the invocation of these bank guarantees shall not form part and parcel of the moratorium.

- iii. That it is denied that NSIC is a secured creditor, or any security interest was created in favour of this Respondent by the corporate debtor. That no charge over the assets of the Corporate Debtor was created in favour of respondent no.1 or that no charge was held by respondent over the assets of the Corporate Debtor. Goods/assets of the Corporate Debtor have been hypothecated with the bank as per the terms and conditions of the agreement dated 11-05-2012 between the respondent no.1 and the Corporate Debtor.
 - iv. That the Respondent No.2 has already lodged its claim before the RP. This claim includes the amount of bank guarantees of Rs. 2,99,00,000/- invoked by the NSIC. This claim has been accepted by the RP. In view of this fact it is not understandable as to why the RP and respondent no. 2 are withholding payment of the bank guarantees invoked by NSIC.
11. Despite of various opportunities, the reply and written submission of the Respondent No. 2 has not been filed.
12. The rejoinder has been filed by the RP, controverting the averments made in the reply and has asserted as follows:
- i. That NSIC has failed to submit the proof that the bank guarantees in question falls under the performance bank guarantee.



- ii. That the NSIC mentioned that irrespective of nature of bank guarantee, Section 14(3) (b) of IBC, 2016 provides for non-applicability of section-14(1) meaning thereof the invocation of these bank guarantees shall not form part and parcel of the moratorium. It is submitted that the provisions of moratorium as per section 14 (3)(b) are not applicable here, as the bank guarantee is given as Financial guarantee to assure the beneficiary about the corporate debtor's intent/capacity of paying money.
- iii. That once the moratorium under Section 14 of IBC, 2016 is declared, then there is a prohibition on any recovery proceedings against the company. Further section 238 of IBC,2016 provides for an overriding effect of the code over anything in consistent therewith contained in any other law for the time being in force or any instruments having effect by virtue of any such law. Once, the moratorium under Section 14 of IBC is in place then no further proceedings, inconsistent with IBC, can be undertaken by any one and hence prohibited.
- iv. That bank guarantees submitted by the corporate debtor are only financial guarantees as they were submitted only for obtaining raw material assistance against bank guarantee. That the recovery of Rs. 2.99 crores by NSIC through invocation of Bank Guarantee may also fall in the ambit of preferential transactions as per section 43(2) of IBC, 2016 and be required to be restored back in terms of section 44 of IBC, 2016 as this recovery would place the

NSIC, being financial creditor in beneficial position than it would have been in the event of a distribution of assets being made in accordance with section 53. However, the IBC, aims at value maximisation of all the stakeholders and the distribution of assets in an equitable and a rule-based manner. Accordingly, it is opined that invocation of Bank Guarantees would affect the CIRP proceedings and thus barred by moratorium.

- v. That it is the duty of the RP to take necessary action to protect the assets of corporate debtor till completion of CIRP i.e. to take all legal steps to protect such invocation / encashment of bank guarantees. Any creditor who is owed money by a corporate debtor under insolvency resolution is required to approach the IRP/RP and file its claim and cannot invoke a bank guarantee to settle its dues or receive payments while the CIRP is ongoing.

13. The written submission has been filed by the RP and has asserted as follows:

- i. Legal issue involved in this matter is that whether the bank guarantee issued by the bank is Performance Bank Guarantee or Financial Bank Guarantee. RBI which is the regulatory body for the banks vide circular dated 02.04.2013, clarified the meaning of both types of the bank guarantees which is as under:

a) Financial Bank Guarantee

Financial guarantees are direct credit substitutes wherein a bank irrevocably undertakes to guarantee the repayment of a contractual financial obligation. Financial guarantees essentially carry the

same credit risk as a direct extension of credit i.e., the risk of loss is directly linked to the credit worthiness of the counter party against whom a potential claim is acquired. An indicative list of financial guarantees, attracting a credit conversion factor (CCF) of 100 per cent is as under:

- (i) Guarantees for credit facilities;
- (ii) Guarantees in lieu of repayment of financial securities;
- (iii) Guarantees in lieu of margin requirements of exchanges;
- (iv) Guarantees for mobilisation advance, advance money before the commencement of a project and for money to be received in various stages of project implementation;
- (v) Guarantees towards revenue dues, taxes, duties, levies etc. in favour of Tax/ Customs / Port / Excise Authorities and for disputed liabilities for litigation pending at courts;
- (vi) Credit Enhancements;
- (vii) Liquidity facilities for securitisation transactions;
- (viii) Acceptances (including endorsements with the character of acceptance);
- (ix) Deferred payment guarantees.

b) Performance Bank Guarantee

Performance guarantees are essentially transaction-related contingencies that involve an irrevocable undertaking to pay a third party in the event the counterparty fails to fulfil or perform a contractual non-financial obligation. In such transactions, the risk of loss depends on the event which need not necessarily be related to the creditworthiness of the counterparty involved. An indicative list of performance guarantees, attracting a CCF of 50 per cent is as under:

- (i) Bid bonds;
- (ii) Performance bonds and export performance guarantees;
- (iii) Guarantees in lieu of security deposits / earnest money deposits (EMD) for

participating in tenders;

- (iv) Retention money guarantees;
- (v) Warranties, indemnities and standby letters of credit related to particular transaction.

On analysis of the above circular of RBI it is clear that the main point of distinction is contractual financial obligation & contractual non-financial obligation in order to determine the nature of bank guarantee.

- ii. That in the Common trade parlance, Performance bank guarantee secures the beneficiary/vendee towards timely completion and the faithful performance of the Contract for provision of goods and services as per terms and conditions specified in the Contract which is a kind of a contractual non-financial obligation. In a case where the contractor /vendor fails to provide goods and services as per terms and conditions specified in the Contract, the bank will be liable for the contractor /vendor's failure to perform and to pay the amount mentioned in the guarantee document. On the other hand Financial guarantee is when the bank assures the beneficiary/lender about the borrower's intent of paying money which if the borrower is unable to pay as per the contract, the bank will pay on behalf of the borrower.
- iii. RBI circular clearly clarified that Bank Guarantee is a Performance Bank Guarantee if a bank guarantee is irrevocable undertaking to pay a third party in the event the counterparty fails to fulfil or perform a contractual non-financial obligation. Here RBI emphasize the word contractual non-financial obligation to determinethe nature of bank

guarantee.

- iv. RBI has also in the indicative list mention that credit facility is a financial bank guarantee and in the present case CD has availed credit facility in the name of raw material financial assistance scheme in which NSIC periodically received monthly interest from the CD which can be verified from statement of accounts as prepared by the CD wherein monthly interest is being charged by the NSIC.
 - v. That in case of performance bank guarantee, banks are specially mention the bank guarantee as Performance Bank Guarantee which is not there in the present case.
14. The written submissions have been filed by the Respondent No. 1/NSIC and has asserted the same averments as made in their reply.
 15. Considering the documents on record and submissions made, we are of the view that the invocation of bank guarantee by NSIC in present case is not in consonance with provisions of code. While deciding this, aspect which needs to be looked into is whether present bank guarantee falls under the category of 'Performance Bank Guarantee' to qualify to exclude the same as per the provisions of section 3 (clause 31) of the I & B Code, 2016 and allow the invocation of such performance bank guarantee irrespective of the moratorium under section 14 of the code. The answer is No. The definition and categorization of bank guarantees as per RBI guidelines clearly demarcates the area while considering particular bank guarantee for its classification. Name itself suggests financial bank guarantee for financial assistance and performance bank guarantee for non-performance of obligations in terms of

performance of contract. NSIC admittedly was secured by bank guarantee against the purchase of raw materials and other allied purchases to enhance manufacturing of a unit, which is financial assistance to the unit. Nowhere the ingredients of performance bank guarantee are seen in the terms /clauses of bank guarantee in present case. Moreover, the Respondent No. 2 bank while filing its claim before RP has included the amount of bank guarantee in its total claim which is admitted by RP. Thus, the same claim cannot be allowed considered as payable twice though submitted by parties in different capacities.

16. As a consequence of above discussion, we allow the application and quash notices issued for invocation of bank guarantee by Respondent No. 1. A copy of the order shall be communicated to the Applicant and the Respondents by the Registry. A copy of the order shall be forwarded to IBBI for its records. The application is disposed of in terms of above order.

SD/-

(MS. SUMITA PURKAYASTHA)
MEMBER (T)

SD/-

(DR. DEEPTI MUKESH)
MEMBER (J)