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EXPLORING PERSONAL GUARANTORS RIGHTS IN INSOLVENCY AND BANKRUPTCY CODE: A COMPREHENSIVE ANALYSIS

INTRODUCTION

The 2016 established law, Insolvency and Bankruptcy Code has made many inroads into our old beliefs and understanding the issue which requires abandoning most of the old conceptions learned over the years. The Insolvency and Bankruptcy Code, 2016 was enacted in India, revolutionising the insolvency landscape by establishing a comprehensive framework for resolving corporate insolvencies. Along with this, the IBC has made major changes to the liability of personal guarantors.

The concept of guarantee, as introduced and clarified in Section 126¹ of the Indian Contracts Act, 1872, obligates a surety to abide by the guarantee of the principal debtor by paying the principal debtor's present or future debt, as delivered to him by a creditor. Without the four components of a guarantee contract: (1) a guarantee contract (2) suretyship (3) principal debtor and (4) creditor the transaction would be a basic contract.

Since its inception, the IBC has undergone numerous changes. It is a living legislation that has evolved to meet the changing requirements of society. One of the most recent amendments to the IBC is the addition of personal guarantors to corporate debtors.

LEGISLATIVE FRAMEWORK

The judiciary played a pivotal role in interpreting and clarifying various provisions of the IBC. Since the IBC was a new legal framework, it was essential to establish precedents and provide clarity in its application.

¹ Contract Act, 1872, S. 126.

A 'personal guarantor', as per Section 5(22)² of IBC refers to a person who acts as a surety in the contract of guarantee to a corporate debtor.

In *State Bank of India v. Ramakrishnan*³ case, the Hon'ble Supreme Court of India has to decide whether section 14⁴ of the IBC, which establishes a moratorium for a set amount of time, would also apply to a personal guarantor of a corporate debtor. It was clarified by the Hon'ble Court that the moratorium is applicable only on the corporate debtor and not the personal guarantors.

Again, the questions pertaining to the corporate guarantors arose for consideration before the National Company Law Appellate Tribunal in the matter of *Dr. Vishnu Kumar Agarwal vs Piramal Enterprises Ltd.*⁵. The Hon'ble Court held that before initiating the CIRP against the corporate guarantors, it is not necessary to initiate CIRP against the Principal Borrower.

In November 2019, the Government of India introduced a significant amendment to the IBC, bringing personal guarantors within its purview and the same was enforced from 01.12.2019. Prior to this amendment, personal guarantors were not directly subjected to the insolvency process. The notification extended the right to prosecute to the banks and financial institutions as well, which increased the risk and liability of the personal guarantors of the corporate debtor's multi-fold.

INSOLVENCY PROCESS FOR PERSONAL GUARANTORS

With the amendment, a creditor may now begin insolvency proceedings against a corporate debtor's personal guarantor under Chapter III of the Insolvency & Bankruptcy Board of India. The process for personal guarantors is very similar to the IBC's corporate insolvency resolution process.

Relying on the judgement of *Maharashtra SEB v. Official Liquidator*⁶, the Court held that within the meaning of Section 128⁷ of the Contract Act, in a case of an unequivocal guarantee, the liability of the guarantor continues as there is no discharge under Section 134⁸ of the Contract Act. Therefore, the discharge of liability of the corporate debtor due to an operation

² Insolvency and Bankruptcy Code, S. 5(22).

³(2018) 17 SCC 394.

⁴ Insolvency and Bankruptcy Code, S. 14.

⁵ 2019 SCC OnLine NCLAT 542.

⁶ (1982) 3 SCC 358.

⁷ Contract Act, 1872, S. 128.

⁸ Contract Act, 1872, S. 134.

of law in liquidation proceedings does not ipso facto absolve the personal guarantor from its liability.

Reliance was also placed upon case of *SBI v. V. Ramakrishnan*⁹ wherein the Supreme Court held that a discharge of liability could not be sought by the guarantor upon approval of a resolution plan which could contain terms allowing continuation of debt of the guarantors.

Eventually, the Hon'ble Court held that Section 31(1)¹⁰ makes it clear that the guarantor cannot escape payment, since the resolution plan, which has been approved by NCLT, may also include the provisions of payments to be made by such guarantor. Therefore, finality to the insolvency proceedings *per se* does not operate as a discharge of guarantors' liability under the contract of guarantee.

CONSTITUTIONALITY OF NOTIFICATION: ANALYSIS OF LALIT KUMAR CASE

The main issue in *Lalit Kumar Jain v. Union of India*¹¹ case was to decide the constitutional validity of 2019 notification of Central Government. Prior to the notification, the power to initiate a proceeding of IBC against the personal guarantor vested with the Debt Recovery Tribunal but after the notification the right has been given to banks, increasing the liability of personal guarantors.

BENEFICIAL FOR CREDITOR, PITFAL FOR GUARANTOR: DILIP B. JIWRAJKA CASE

In the *Dilip B. Jiwrajka v. Union of India*¹², the Hon'ble Supreme Court addressed the challenge to the constitutional validity of the provisions pertaining to a personal guarantor's insolvency. More specifically, there was a challenge to the constitutionality of Sections 95(1), 96(1), 97(5), 99(1), 99(2), 99(4), 99(5), 99(6), and 100 of Insolvency and Bankruptcy Code.

It should be noted that the personal guarantors' quick and efficient insolvency resolution process may benefit the creditors. The personal guarantor's creditworthiness and financial status may be negatively impacted for some time by the insolvency resolution process. The

⁹ (2018) 17 SCC 394.

¹⁰ Insolvency and Bankruptcy Code, S. 31(1).

¹¹ (2021) 9 SCC 321; 2021 SCC OnLine SC 396.

¹² 2023 SCC OnLine SC 1530.

potential for “multiple and concurrent insolvency proceedings” is one such worry. Due to the guarantors’ and debtors’ joint liability, creditors are able to file for bankruptcy simultaneously against both, which presents operational challenges and jurisdictional conflicts for NCLT. Now, complexity is increased, for example, when a guarantor offers guarantees to businesses in different locations and concurrent CIRPs are started in multiple cities. The guarantors are not given any escape from this under the Code.

CONCLUSION

The IBC was implemented to offer a simplified and quicker procedure for handling the insolvency of individuals and corporate entities.

A paradigm shift has occurred in India’s bankruptcy landscape with the introduction of personal guarantors’ liabilities under the Insolvency and Bankruptcy Code, 2016. The development of personal guarantor clauses in insolvency and bankruptcy legislation reflects the shifting dynamics of the financial, commercial, and legal environments. These clauses have evolved from informal agreements to intricate legal frameworks that strike a balance between creditors’ rights and personal guarantors’ rights.