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LAW OF GUARANTEE & ITS SCOPE UNDER IBC

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ABSTRACT

The contract of guarantee is an auxiliary assurance that is brought into existence owing to the presence of the main contract between the main indebted person and the Creditor[1]. In course of producing this paper, the main goal is to have a full understanding of the current scope of the Contract of guarantee according to the Insolvency and Bankruptcy Code of 2016. It was imposed as a means of establishing financial order in India in 2016 when the IBC was implemented. Incorporating several changes to norms and legislation about insolvency, the IBC established a wide range of reforms throughout the country. One other area of debate concerned the handling of the underwriter of a corporate indebted person going through bankruptcy procedures, which, likewise has been altered often since the passage of the IBC. Through this study, the author will attempt to comprehend and describe the same, as well as to explore the parameters of a guarantee agreement governed by IBC.

Keywords: Insolvency, Guarantee, Moratorium, Debts, Creditor

INTRODUCTION

In Section 126 of the Indian Contract Act, 1872[2], you can find details about the contract of guarantee. In the event of a default, a contract where there is a guarantee is an agreement to fulfill an offer or release a responsibility that has been incurred by a third party. The three main participants in the guarantee contract are the guarantor, the beneficiary, and the assured. The guarantee or is the one who issues the guarantee. The second part is the main indebtor, the guarantee is granted to that person and due to that person's failure, the guarantee is provided. The third party is the Creditor, who is the one to whom the guarantee is provided.

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[1] Patrick Kilonzo, 'Company Law Notes Kenya' (Academia.edu, 2021). .https://www.academia.edu/36647497/Company_Law_Notes_Kenya accessed 6 June 2021.

[2] The Indian Contract Act, 1872 (Act No. 9 of 1872).

Understanding the terms and conditions of a guaranteed contract under IBC is crucial for us since without this we won't comprehend the actual extent of that contract.

According to the Insolvency and Bankruptcy Code of 2016[3], both businesses, as well as individuals, are covered. There is a time-limited insolvency resolution procedure that is guaranteed. In the case of the default in the repayment, the debtor's assets are in the control of the creditors, who have to choose to create the insolvency resolution within 180 days. It is designed to safeguard debtors during the period that is spent in a resolution phase, so they will not have to worry about being sued by creditors while the process is in this state. To make this a central location for debtors and creditors to seek bankruptcy, rules under the current legislative framework are integrated to provide a single forum where both parties may submit claims. A reference to the section mentioned earlier in this article is stated here: The obligation of guarantee is co-broad with that of the essential indebted person except if it is determined in the agreement. A chief account holder is alone responsible for all the debt owed to other creditors. Surety's culpability is likewise joint, many, as well as co-broad with the essential borrower.[4]

OBJECTIVES

- To comprehend the process of corporate bankruptcy.
- To learn about the commencement of the Corporate Insolvency Proceedings against the Guarantor.
- To comprehend the right of the guarantor to recover the debts via the process of Insolvency.
- To comprehend the legal actions against the personal guarantor for violation of IBC.

A BRIEF HISTORY OF IBC

The Ministry of Finance established the Bankruptcy Legislative Reforms Commission [5]in 2014, which was tasked with the responsibility of developing updated bankruptcy legislation that included all of the current norms and practices, and filled the gaps left by current laws in the same field of law. BLRC established a consolidated effort that covered all of the current bankruptcy rules. This included every subject related to that issue, which included both humans and legal organizations on the subject of the BLRC report began after the study results were

[3] The Insolvency And Bankruptcy Code, 2016 (No. 31 of 2016).

[4] Ganshyam Singh, 'The Surety'S Obligation To Pay Would Arise Immediately On Default Committed By The Principal Debtor And Once A Cause Of Action Against The Surety Has Arisen The Commencement Of The Running Of Time Is Not Further Postponed Till The Making Of A Demand-Montosh Kumar Chatterjee V Central Calcutta Bank Ltd.-Calcutta High Court' (IBC Laws, 2021) https://ibclaw.in/the-suretys-obligation-to-pay-would-arise-immediately-on-default-committed-by-the-principal-debtor-and-once-a-cause-of-action-against-the-surety-has-arisen-the-commencement-of-the-running-of/ accessed 6 June 2021.

[5] 2021) https://www.ibbi.gov.in/BLRCReportVol1_04112015.pdf accessed 6 June 2021.

presented to Parliament. Thus, in the long run, new methods for adding new features, including user comments and ideas, were added to the centralized code, which culminated in the IBC. The IBC (Interim Building Code) was submitted to Parliament in 2015 and enacted in 2016. This law is a unified code that incorporates a variety of insolvency and bankruptcy statutes, the Companies Acts of 2013 and 1956, the RDBFI Act, the SARFAESI Act, and the SICA Act, in addition to the Company Dissolution Code, the Loan Discharge and Benefit Claims Resolution Act, and the Consumer Protection Act.

THE PROCESS OF INSOLVENCY

To initiate insolvency proceedings, a creditor or the corporate debtor would first file a motion in court (or an administrative complaint if this kind of proceeding is brought under federal, state, or provincial laws). To ensure that an Interim Resolution Professional takes control of the company's operations, the tribunal first designates a Resolution Consultant who examines the existing condition of affairs. Furthermore, he has been assigned to get the CoC together and formulate a course of action for dealing with the Insolvency Resolution. In the case of bankruptcy, as per the arrangements of the Indian Insolvency and Bankruptcy Code[6], a debtor's insolvency procedures shall be completed within 180 days. After the borrower or the corporate debtor decides to proceed with the process in the NCLT, this occurs. Following that, the creditors' claims remain in a state of deferment for six months while the NCLT processes the insolvency plan.

In this period, the NCLT (National Committee for Reconciliation)[7] decides on the prospective result for the Corporate Debtor (i.e. whether the recovery plans used by the IRP (Interim Insolvency Resolution Professional) have succeeded or failed). This is an efficient strategy that has been put in place to resuscitate the company's existence originally outlined in the SICA Act. This is stated in more detail here and now because, until a plan is presented to settle the corporate debtor's obligations or the liquidation process is initiated, meaning that no legal action will be conducted against the corporate indebted person in any court or other venue for collection of debt.

MORATORIUM

One of the several purposes of adopting the present "all-encompassing" bankruptcy laws is to provide a sufficient amount of time for the corporate debtor to resuscitate the business, which is done by suspending all debt collection and the activities of the creditor. Also, with this schedule, there is plenty of time for debtors and creditors to rework their debt. With the enactment of the

[6] IBC 2016.
[7] 'Welcome To NCLT | NCLT' (Nclt.gov.in, 2021) https://nclt.gov.in/ accessed 6 June 2021.

legislation establishing the Committee on Banking Law Reforms[8], creditors now cannot recover their dues if they are held up for more than ten years.

Accordingly, this means that the enterprise's loan bosses won't start legitimate activity against the corporation. To ultimately help the firm to achieve financial self-sufficiency, this is done. When read from Section 14 of the IBC, these are some of the goals of the moratorium as set out:

- Keeping the corporate debtor's properties intact during the insolvency resolution phase making it possible to follow through on all of the actions taken in the event of an insolvency
- By adding a maintenance loan, the firm is assured that it will be able to continue functioning as a current obligation until creditors decide on the default settlement as well as the moratorium on initiation.
- As a result of the prolongation of court litigation, including debt compliance measures, borrowers will have to wait a time while they cannot take individual regulatory action, which may make the main goal of the corporate bankruptcy settlement process more difficult to accomplish.

The list of prohibited acts included in Section 14 of the IBC is covered by this paragraph, which includes: Every claim or order against the Corporate Debtor should be filed, followed up on, and carried out. When moving, distancing, or discarding the business's possessions or inherent rights, the firm is allowed to use such assets or inherent rights.

The recovery of a corporate debtor's security interest, or the accomplishment of corporate debtor protection objectives (including action as under the SARFAESI Act), Where the Corporate Debtor holds ownership or occupies the premises, the restoration work might be done by the owner or lessor.

This is according to Section 14(4) of IBC[9], which provides that the ban is implemented from the date of publication and is to be kept in force until the completion of the corporate insolvency resolution procedure. According to Section 12, this corporate bankruptcy resolution procedure must be completed within 180 days, although it may be extended for up to 90 days if the Committee of Creditors considers it necessary, with a 75 per cent majority in favour. While M/S. Innoventive Industries Ltd. v. ICICI Bank [10]has these same basic premises, the courts once again ruled in favour of this assumption.

[8] (2021) https://ibbi.gov.in/BLRCReportVol1_04112015.pdf accessed 6 June 2021.
[9] IBC 2016.
[10] *M/S. Innoventive Industries Ltd. v. ICICI Bank*, (2017) SCC OnLine SC 10251.

ANALYSIS

To Start the Corporate Insolvency Proceedings against Guarantor[11] This is also of the utmost importance, and it would have to be that the guarantor is equally liable with the one owing the amount. This feature enables the creditor to also file charges against the primary debtor as well as the guarantor. Before initiating legal action against the corporate indebted person, the monetary/operational lender will not have to search for and attempt to identify the guarantor, and will not have to proceed with action against the guarantor until contacting the guarantor before filing for bankruptcy against the guarantee. Concerning securing a guarantee, this would frustrate our purpose since the Creditor would be prohibited from taking any action against the financial/operational creditor to postpone the use of remedies due to this interfering with creditor rights.

Section 60(2) was construed by the court during the Sanjeev Shriya v. State Bank of India [12]case, where it was recognized that creditors had the right to act against the guarantor of the corporate debt holder. To better communicate the meaning of legislator, the phrase "an application about the insolvency resolution or bankruptcy of a personal guarantor of such corporate debtor must be brought before the NCLT" mean that both the corporate debtor and the guarantee will be equally accountable for any obligations incurred. On the same note, the Supreme Court has adopted this interpretation by dismissing the Civil Appeal and by maintaining the famous ruling of the National Company Law Appellate Tribunal (NCLAT)[13] in the case of Ferro Alloys Corporation Limited vs. Rural Electrification Corporation Limited[14].

The ruling was delivered in the favour of the Financial Creditor; in this instance, it was Rural Electrification Corporation Limited. Because in this instance, the Supreme Court accepted NCLAT's finding that the bankruptcy procedures might continue in opposition to the Corporate Guarantor without additionally continuing in opposition to the Principal Debtor, the court decided that the insolvency proceedings against the Corporate Guarantor were permissible. Section 14 of the IBC, in essence, permits a moratorium for a certain period from the date of the onset of bankruptcy. To be complete, it also must contain that the formation and continuation of litigation or the competent authority's execution of every decision, declaration, or regulation against the corporate debtor, as well as the execution of every decision, declaration, or regulation by the competent authority.

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[11] 'Supreme Court Says Personal Guarantors Liable For Corporate Debt' (The Hindu, 2021) https://www.thehindu.com/news/national/sc-upholds-centres-notification-permitting-banks-to-proceed-against-personal-guarantors-under-ibc/article34612708.ece accessed 6 June 2021.

[12] *Sanjeev Shriya v. State Bank of India*, (2018) AIR CC.

[13] 'National Company Law Appellate Tribunal (NCLAT)' (Nclat.nic.in, 2021) https://nclat.nic.in/ accessed 6 June 2021.

[14] Ferro Alloys Corporation Limited vs. Rural Electrification Corporation Limited, (2018) SCC OnLine NCLAT 71.

About the validity of the moratorium imposed on the guarantor according to Section 14 of the IBC, different tribunals and courts have taken different viewpoints, with few telling that the ban applied according to IBC as mentioned in Section 14 is appropriate and pertinent, and others saying that it is not. This was the question that came before the NCLAT during the State Bank of India v. V Ramakrishnan and Veesons Energy Limited [15]case, which was whether the period of moratorium described in Section 14 of the Insolvency and Bankruptcy Code[16] applies for the Personal Guarantor or not. Mr. V. Ramakrishnan, the guarantor for a loan provided by the State Bank of India to Veesons Energy Systems Pvt. Ltd., lent his guarantee to the company. Using the system's default settings, the creditor first contacted the personal guarantor, who was then instructed to sell his or her possessions and pay the debts. When the moratorium was in force, the Indian Banking Regulation Act (IBRA) prevented the State Bank of India (SBI) to proceed with the suggested course of action. This is because it would have changed the corporate debtor for the damages. Despite Section 14 of the IBC requirements for creditors encumbering assets, which provide that only voluntary assets are acceptable, being unchanged, any asset still becomes encumbered. According to the court presiding over the case, there is minimal doubt concerning the value of this particular charge, which is why it will be defined following Section 140 of the Indian Contracts Act[17].

While used in Sections 14, 30, and 31 of the IBC, the NCLAT recognized that the 'Corporate Debtor' and 'Personal Guarantor' had no assets other than the properties covered by the moratorium, and both of these parties' assets were thus suspended. Therefore, it was deemed, in this situation, a well-known length of the moratorium was also applicable to the guarantor of the corporate indebted person. NCLAT approached the matter differently during Schweitzer Systemtek India Pvt. Ltd. vs. Phoenix ARC Pvt. Ltd. & others[18]. NCLAT stated that the moratorium that had been placed on the property having a place with the underwriter of the corporate borrower as mentioned in IBC in its Section 14 didn't have any significant bearing on the property. While making this proposal, the NCLAT based its thinking on the understanding of the word 'it's' as found in IBC in its Section 14, according to that the property that isn't held by the corporate indebted person doesn't fall in the extent of the ban.

This issue regarding whether a trustee under the bankruptcy law would sell the properties of an individual underwriter was tended to by the Bombay High Court on account of Alpha and

[15] State Bank of India v. V Ramakrishnan and Veesons Energy Limited [Company Appeal (AT) (Insolvency) No. 213 of 2017].
[16] IBC 2016.
[17]ICA 1872.
[18] Schweitzer Systemtek India Pvt. Ltd. vs. Phoenix ARC Pvt. Ltd. & others, (2017) SCC OnLine NCLT 7532.

Omega Diagnostics (India) Ltd. v. Asset Reconstruction Company of India Ltd. and Ors[19]. A panel of judges at the local court has evaluated the phrase "it" in Section 14 of the IBC, 2016, and concluded that personal guarantors of corporate debtors are ineligible for a moratorium. This means that the personal property of the guarantor is now up for sale, and the money raised from the sale is used to pay off the debt.

In a manner befitting a proper interpretation of Section 14 of IBC, the Insolvency Law Committee (ILC) [20]had been established to perform one thorough analysis of IBC, especially in light of the conflicting observations of the settling experts on the pertinence of the moratorium to Guarantors. The International Longshore and Dockworkers' Union (ILC) said that each guarantors' property would remain aside from the purview of the moratorium levied by IBC. All guidelines provided by ILC were followed, resulting in the passage of the Insolvency and Bankruptcy Code (Second Amendment Act), 2018[21]. An interpretation was introduced utilizing the modification indicating that the moratorium does not apply to a guarantee for a corporate debtor. The explanation finally put to rest all the doubt about the extent to which the moratorium allowed by IBC as given in its Section 14 was applicable.

- **Right of a guarantor to recover debts via Insolvency proceedings**

Sometimes, the guarantor can aid the primary debtor in making good on his obligations by forgiving the obligation. It is true that he is in reality tight for money, though. Getting this money back may probably be difficult. In a legal context, the principle of subrogation is to say that the rights of a creditor will be passed to another individual when that person is an essential component in getting the debt paid off. After a guarantor has taken over as the borrower's creditor, he already has the rights formerly owned by the original creditor (such as the right to collect the loan amount).

This notion originates from Morgan v. Seymore[22], in which the bar declared that the guarantor gets the rights of standing in the creditor's shoes after disposing of the primary debtor's obligations. In the Indian court system, a guarantor has the legal rights of creditors safeguarded by being granted all the rights the creditors themselves have. An excellent illustration of this is the case of Amrit Lai Goverdhan Lalan v. State Bank of Travancore[23], where the bar decided that the idea of subrogation is pertinent not exclusively to the agreement of assurance yet in addition

[19] Alpha and Omega Diagnostics (India) Ltd. v. Asset Reconstruction Company of India Ltd. and Ors, (2010) 6 Bom CR 92.

[20] 'Sub-Committee Of Insolvency Law Committee Recommended IBC Pre-Pack Framework' (Pib.gov.in, 2021) https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1703245# accessed 6 June 2021.

[21] (Egazette.nic.in, 2021) https://egazette.nic.in/WriteReadData/2018/188623.pdf accessed 6 June 2021.

[22] Morgan v. Seymore, (1638) 1 Rep Ch 120.

[23] Amrit Lai Goverdhan Lalan v. State Bank of Travancore, 1968 AIR 1432.

to the rule of common equity. Court held, instead of guarantee having all the creditor's protection against the debtor, Section 140 of the ICA says that the guarantee is granted all of the creditor's protection. It is very necessary to make a shift in this scenario.

- **Preliminary proceedings against personal guarantors according to the IBC 2016**

By far the most important reform that was made in the Code is the amendment to the rules on indebtedness as well as bankruptcy (the process for mediating insolvency for underwriters to corporate debt holders) which now bear name of "Insolvency and Bankruptcy (Application to Adjudicating Authority for Insolvency Resolution Process for Personal Guarantors to Corporate Debtors) Rules, 2019 (PG Rules, 2019) and the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Personal Guarantors to Corporate Debtors) Regulations, 2019 (PG Rules, 2019)."[24]

A creditors' rights measure, sometimes referred to as a "new regime," has allowed creditors, besides commencing actions in opposition to the corporate account holder, to commence insolvency actions in opposition to personal guarantors. This structure of the Code is most probably set to be influenced by these unusual situations, since a creditor may start the procedures in opposition to both corporate indebted person as well as the personal guarantors at the same time, which may result in confusion and ambiguity. As of this time, it is unknown on the off chance that the goal specialists of the corporate account holder and the individual underwriter will be working independently or following a guarantee of no double-dipping even by the creditor. Although the present precedents under the Guarantor Code pertain only to corporate guarantors, principles which are comparable to those are quite likely to affect the pending jurisprudence with regards to personal guarantors. Indians who take out a guarantee agreement with the understanding that it would be equal in responsibility to the original creditor are really under the mistaken impression since such a guarantee indicates just one way in which responsibility may be mutual and multiple, meaning creditors may go after the borrower or the guarantor individually, in a group, or simultaneously to get their money back. This situation has already been discussed in previous decisions of National Company Law Tribunals (NCLT), and thus an adjustment was made in the year 2018 to let it be known that potentially the moratorium laid forth in Section 14 of the Code doesn't make a difference to the assurance of a corporate indebted person, and along these lines, the borrower may continue against the underwriters even while the corporate debtor is in the moratorium. If a creditor (e.g. a lender) sues a corporate debtor (e.g. a company), and the assets that are legally segregated (e.g. the company's finances) are not impacted, then a third-party asset cannot be harmed. To better understand this bill, we

[24] (2021) https://ibbi.gov.in/legal-framework/rules accessed 6 June 2021.

must learn about the problem it is trying to solve. Several different legal claims might be recorded against the corporate indebted person and its underwriter under the existing legislation. Thus, according to Dr. Vishnu Kumar Agarwal v. Piramal Enterprises Ltd.[25], in which the National Company Law Appellate Tribunal (NCLAT) declared that while the Code does not include any limitation on pursuing two applications under Section 7 against the major creditor and the corporate underwriter(s), there is an exception to this rule that occurs if the firm petitions for reorganization under Section 7 of the Code. But to that end, if one of the corporate debt holders (either primary borrower or the corporate underwriter) has their creditor appeal granted on a collection of claims, then the other corporate debtor will not be given the authorization to be a creditor on the same set of claims (i.e. either principal indebted person or corporate underwriter). If claims and default cannot be accepted, this is because the same set cannot be accepted. While the choice was decided with regard to corporate underwriters, it is reasonable to deduce that personal guarantors might be subject to the same rule. What this means is that it is unknown if a creditor would file a lawsuit against individual underwriters for the equivalent collection of debts that any business indebted person is presently facing with the possibility of being declared insolvent. As a consequence, the creditor must let go of its case against the underwriter/borrower and reduce its claim to the underwriter/borrower against whom the bankruptcy procedures had been purportedly begun as well as the claim submitted, no matter how essential it is to the creditor's financial position.

To that end, it is perhaps useful to note that the Supreme Court addressed various problems under the Code that were still to be completely resolved in the Committee of Creditors of Essar Steel India Limited vs. Satish Kumar Gupta[26]. Regarding the law for guarantors and the Code, the Supreme Court confirmed a prior judgment from State Bank of India vs. V. Ramakrishna[27], which also acknowledged the creditor's authority to enforce personal guarantee contracts during bankruptcy proceedings, giving the creditor the final option of recovering the amount owed to it. According to an interpretation of the Supreme Court's ruling in Essar Steel (above), a personal guarantor's bankruptcy may arise simultaneously with the bankruptcy of a corporate debtor. However, this seems to conflict with the NCLAT's decision in the Piramal Enterprises case (supra). As a result, there are many more uncertainties that are associated with this new system. The time has come for the government to step in and put an end to this problem.

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[25] Dr Vishnu Kumar Agarwal v. Piramal Enterprises Ltd. Company Appeal (AT) (Insolvency) No. 346 of 2018

[26] Committee of Creditors of Essar Steel India Limited vs. Satish Kumar Gupta, (2021) SCC OnLine SC 30.

[27] State Bank of India vs. V. Ramakrishna CIVIL APPEAL NO. 3595 OF 2018

FINAL REMARKS

Based on the findings of the study, the author believes that the responsibility of a guarantor on some grounds, such as bankruptcy, insolvency, or debt relief, is a little uncertain and also inconsistent. In this insolvency legislation, the guarantor's liability stems from the failure of the primary debtor. Only if a move for insolvency proceedings against a corporate debtor is lodged in line with Section 7 of the IBC, 2016, should only the liability of the corporate debtor be assessed. In this case, the creditor has the option of calling the guarantor to collect payment on the loan. During this research, the author noticed two crucial aspects. These arguments are founded on the decisions of the Courts and Tribunals, as well as the legislation (IBC). The first is that no debt collection actions against a corporate debtor will be carried out while the moratorium is still in force, and no procedures against a corporate debtor's guarantor will be carried out since it would result in a charge on the property. The remedies would have to be postponed by the creditor, according to this analysis. During Industrial Investment Bank of India Ltd. v. Bishwanath Jhunjhunwala[28], on other hand, the apex court held that if the lender is said to postpone his remedy, the whole purpose of the guarantee contract is undermined. As a result, it is preferable to prevent any form of misunderstanding since only legal clarity will secure each party's bounds. We may say that the New Regime is a much-needed legislative measure since it strives to promote competitiveness, maximize asset value, and speed up the acquisition measure. In any case, it seems that the assembly has fallen into the traditional snare of ambiguity and therefore finding itself in a state of constant uncertainty while discussing the insolvency theory's dynamics and uncertainties. To make sure that the New Regime is successful, the courts will have to take the reins again.

[28] Industrial Investment Bank of India Ltd. v. Bishwanath Jhunjhunwala, (2009) Supreme Court Cases 478.