

VI. EVOLVING LIABILITY OF PERSONAL GUARANTORS UNDER THE IBC: BALANCING CREDITOR’S RIGHTS AND GUARANTOR PROTECTIONS AMIDST EMERGING TRENDS

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ABSTRACT

The Insolvency and Bankruptcy Code (IBC) has been pivotal in streamlining insolvency resolution in India, reducing case timelines, and recovering distressed assets. However, the 2019 Amendment, which brought personal guarantors under the IBC's scope, has introduced new challenges. Recovery rates from personal guarantors remain low, and the Code lacks provisions for asset tracing, leaving creditors exposed to fraudulent transfers of guarantor assets before proceedings. Furthermore, ambiguity around personal guarantor liabilities, especially following their death, has led to inconsistent judicial interpretations, complicating creditor recovery. This study uses a doctrinal approach and identifies critical gaps in the current framework, emphasizing the need for targeted reforms. Despite the IBC's success in bolstering creditor confidence, personal guarantors face heightened risks, and enforcement remains weak. The paper advocates for establishing specialized tribunals to handle guarantor disputes, introducing robust asset-tracing mechanisms, and clearer liability rules for personal guarantors, including after death. These reforms are essential for creating a balanced and efficient insolvency regime that protects creditors while addressing the vulnerabilities faced by personal guarantors in India's evolving financial landscape.

Keywords: Insolvency and Bankruptcy, Liability of a Personal Guarantor, Personal Guarantor to a Corporate Debtor, Insolvency Resolution Process, Cross-Border Insolvency

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I. INTRODUCTION

The Insolvency and Bankruptcy Code (“IBC”), introduced in 2016, serves as a comprehensive legal framework designed to “*address the insolvency and bankruptcy of corporate entities, partnership firms, and individuals within a specified timeframe*”.¹ Before the implementation of the IBC, provisions related to insolvency and bankruptcy were scattered across multiple laws, including the Sick Industrial Companies (Special Provisions) Act of 1985, the Recovery of Debt Due to Banks and Financial Institutions Act of 1993, the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act of 2002, and the Companies Act of 2013. This fragmented legal environment often led to significant procedural complexities, resulting in delays in insolvency resolutions.

¹ The Insolvency and Bankruptcy Code 2016.

The IBC, aims to "*maximize the value of assets, promote entrepreneurship, ensure the availability of credit, and balance the interests of all stakeholders*".² It furthers main objectives of streamlining and consolidating the existing insolvency resolution laws, facilitates the reorganization of distressed assets, and ensures the timely resolution of cases. Additionally, the Code establishes the Insolvency and Bankruptcy Board of India ("IBBI") to regulate and oversee the insolvency process. The National Company Law Tribunal ("NCLT") serves as the adjudicating authority for resolving cases under the Code, ensuring timely and effective resolution.

One of the most significant achievements of the IBC is the considerable reduction in the time taken to resolve insolvency cases. As highlighted by a report from the Standing Committee on IBC, published in August 2021, the average time required for resolution dropped from 4.3 years to just 1.6 years between 2017 and 2020, following the Code's implementation.³ This reduction has allowed for faster recovery and resolution of distressed assets, benefitting both creditors and debtors.

Since the enactment of the Code, lenders have successfully recovered over ₹3.5 lakh crore through insolvency proceedings, with more than 1,000 resolution plans being approved by the NCLT.⁴ "*The recovery rate has also significantly improved, rising from 26 cents to 71.6 cents on the dollar*".⁵ This

² The Insolvency and Bankruptcy Code 2016.

³ Standing Committee on Finance, *Implementation of Insolvency and Bankruptcy Code – Pitfalls and Solutions* (August 2021) <<https://ibbi.gov.in/uploads/resources/fc8fd95f0816acc5b6ab9e64c0a892ac.pdf>> accessed 6 October 2024.

⁴ PTI, 'Lenders Have Recovered Rs 3.5 Lakh CR under IBC: Ravi Mital' *The Economic Times* (1 October 2024) <<https://economictimes.indiatimes.com/news/economy/finance/lenders-have-recovered-rs-3-5-lakh-cr-under-ibc-ravi-mital/articleshow/113852515.cms?from=mdr>> accessed 6 October 2024.

⁵ PIB, "'Insolvency and Bankruptcy Code (IBC), 2016 a Gamechanger Reform": Shri Piyush Goyal' (*Press Information Bureau 25 November 2021*) <<https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1775096>> accessed 6 October 2024.

increased efficiency in recovery has bolstered the confidence of financial institutions and investors in the insolvency resolution process, thereby contributing to the overall stability of the financial ecosystem.

The IBC was designed to resolve insolvency issues for both corporate entities and individuals in a time-bound manner, with the goal of maximizing asset value. Although the IBC primarily targets corporate insolvency, it also encompasses individuals. The insolvency resolution process for individuals, prior to the enactment of the IBC, was regulated by the Presidency Towns Insolvency Act of 1909 and the Provincial Insolvency Act of 1920. However, both these acts were repealed effective from August 19, 2016 by virtue of Section 243 of the Code.⁶

Section 5(22)⁷ of the IBC defines a "Personal Guarantor" ("PG") as an individual who acts as the surety in a contract of guarantee for a corporate debtor. Section 128 of the Indian Contract Act, 1872⁸, stipulates that "The liability of the Surety is co-extensive with that of Principal Debtor unless mentioned in the Contract". This provision also applies to PGs who act as sureties for corporate debtors. One important Amendment to the IBC in 2018 categorized individuals into three groups: PGs to corporate debtors, partnership firms and proprietorship firms, and other individuals, and made provisions of the code applicable to this group. In November 2019, the Central Government introduced provisions under the IBC to address the insolvency

⁶ Parijat SB and, 'Supreme Court's Verdict on the Constitutionality of the Provisions of Personal Guarantors under the IBC' (*Live Law*, 8 February 2024) <[⁷ Insolvency and Bankruptcy Code 2016, s 5\(22\).](https://www.livelaw.in/law-firms/law-firm-articles-/supreme-court-personal-guarantors-ibc-presidency-towns-insolvency-act-cirp-nclat-resolution-professional-248885#:~:text=its%20personal%20guarantors.-,IRP%20OF%20PERSONAL%20GUARANTORS,proceedings%20of%20a%20personal%20guarantor.> accessed 6 October 2024.</p></div><div data-bbox=)

⁸ Indian Contract Act 1872, s 128.

resolution and bankruptcy process for PGs of corporate debtors.⁹ This move allowed creditors to initiate insolvency proceedings against both corporate debtors and their Personal Guarantors simultaneously, as both are linked to the same debt. By enabling concurrent proceedings, this Amendment strengthened creditors' chances of recovery and promoted a more cohesive and integrated approach to resolving insolvency matters.

According to Section 60¹⁰ of the code the NCLT is the Adjudicating Authority (“AA”) in case of insolvency and bankruptcy proceedings of the PGs to corporate debtors. Under Section 95¹¹ of the Code, both PGs and Creditors can file an application for the insolvency resolution process of PGs, either by themselves or through a Resolution Professional, before the NCLT. The Resolution Professional appointed by the AA examines the application and submits a report to the AA. The AA then decides whether to accept or reject the application. If the application is accepted, the Resolution Professional calls for claims from creditors and devises a debt repayment plan. This proposed plan requires approval from the majority of creditors; failure to obtain such approval will result in bankruptcy proceedings against the PGs. The interpretation and enforcement of PG liability, however, have been continuously shaped by judicial decisions. To understand the evolving nature of this liability, it is essential to examine the landmark cases where courts have clarified the scope and responsibility of personal guarantors under the IBC.

II. EVOLUTION OF PERSONAL GUARANTOR LIABILITY IN INDIAN JUDICIARY

With the foundation of PG liability established in the IBC, the Indian judiciary has played a crucial role to shape the accountability of PGs under the

⁹ The Insolvency and Bankruptcy Code (Amendment) Act 2019.

¹⁰ Insolvency and Bankruptcy Code 2016, s 60.

¹¹ Insolvency and Bankruptcy Code 2016, s 95.

Code. In the following section, we will explore landmark cases that have influenced the liability of PG, further clarifying their role in the insolvency resolution process and the procedural aspects of insolvency proceedings under the IBC. One such significant case is *Vishnu Kumar Agarwal v. Piramal Enterprises Ltd*¹² in which the court held “*that once a petition under Section 7¹³ of the IBC is filed against the principal debtor or guarantor and once the Corporate Insolvency Resolution Process (CIRP) has been initiated, the financial creditor cannot file another application on the same set of claims against the other debtor*”. The court also clarified that it is not necessary to initiate CIRP against the principal borrower before commencing it against the corporate guarantor. The Hon'ble Appellate Authority in the case of *SBI v. Athena Energy Ventures (P) Ltd*¹⁴ affirmed that the IBC permits the concurrent initiation of Corporate Insolvency Resolution Process (CIRP) against both the principal borrower and the corporate guarantor it held that “*Referring to Section 5(8)(a), (h) and (i) of IBC, it is argued that IBC treats the principal borrower and guarantor similarly*”. Section 14¹⁵ of the IBC “*In which the AA by order declares moratorium for prohibiting all of the following*

(a) the institution of suits or continuation of pending suits or proceedings against the corporate debtor including execution of any judgment, decree or order in any court of law, tribunal, arbitration panel or other authority (b) transferring, encumbering, alienating or disposing of by the corporate debtor any of its assets or any legal right or beneficial interest therein;

¹² *Vishnu Kumar Agarwal v. Piramal Enterprises Ltd* [2019] SCC OnLine NCLAT 542 (NCLAT).

¹³ Insolvency and Bankruptcy Code 2016, s 7.

¹⁴ *State Bank of India v. Athena Energy* [2020] SCC OnLine NCLAT 774 (NCLAT).

¹⁵ Insolvency and Bankruptcy Code 2016, s 14.

(c) 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 *Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (54 of 2002)*;

(d) the recovery of any property by an owner or lessor where such property is occupied by or in the possession of the corporate debtor.”

In *State of Bank of India v. V. Ramakrishnan & Anr.*¹⁶ the Supreme Court ruled that “*the moratorium does not apply to personal guarantors of corporate debtors*”. In 2019, the Union Government issued a notification addressing the liability of personal guarantors. Prior to this, personal guarantors were not directly subject to insolvency proceedings. However, following this Amendment, creditors can now initiate insolvency proceedings against the personal guarantor of a corporate debtor. According to Section 95¹⁷ of IBC, creditors may initiate bankruptcy proceedings against the personal guarantors of a corporate debtor. Under Section 96,¹⁸ an interim moratorium applies to personal guarantors once an insolvency application is filed. This interim moratorium is similar to the moratorium under Section 14,¹⁹ which applies to corporate debtors. Numerous petitions were filed across the country challenging the notification. The Supreme Court consolidated all the petitions and delivered its ruling in the landmark case of *Lalit Kumar Jain v. Union of India*.²⁰ The petitioners argued that the notification involved “excessive delegation” and was *ultra vires* the powers conferred upon the Union Government. They also contended that it violated Article 14 of the Constitution and was manifestly arbitrary, as it singled out personal guarantors

¹⁶ *SBI v. V. Ramakrishnan* [2018] 17 SCC 394 (SC).

¹⁷ Insolvency and Bankruptcy Code 2016, s 95.

¹⁸ Insolvency and Bankruptcy Code 2016, s 96.

¹⁹ Insolvency and Bankruptcy Code 2016, s 14.

²⁰ *Lalit Kumar Jain v. Union of India* [2021] 9 SCC 321 (SC).

to corporate debtors without any intelligible differentia or rational basis for such classification. Furthermore, the petitioners argued that personal guarantors were being denied their rights of subrogation. The Court held “*that the provisions in question were not ultra vires the legislatures that enacted the law containing those provisions*”. It reasoned that the Amendment was necessary because personal guarantors of corporate debtors undergoing insolvency proceedings should also be subjected to the same adjudicatory process. To achieve this, the required Amendments were made. The Court further clarified that personal guarantors would remain liable, even if the corporate debtor is discharged from its obligations.

The constitutional validity of Sections 95-100 of the IBC was challenged in *Dilip B. Jiwrajka v. Union of India*²¹ the petitioners argued that personal guarantors were not given an opportunity to present their case during the filing of the insolvency application or at the time of appointing a resolution professional. However, the court ruled that these provisions do not violate Article 14 and are not manifestly arbitrary.

The Supreme Court's recent decision is particularly advantageous for banks and financial institutions that utilize public funds, as it equips them with another mechanism for recovering bad debts. Following the notification dated November 15, 2019, foreign assets held by personal guarantors of corporate debtors can also be seized in insolvency or bankruptcy proceedings. Additionally, “*the NCLT has the authority to attach such foreign assets during the corporate debtor’s insolvency process. The judgment establishes a solid legal framework for creditors, particularly banks and financial institutions, to efficiently recover bad debts. However, this raises concerns about the potential dominance of lenders and the importance of adopting a balanced*

²¹ Dilip B. Jiwrajka v. Union of India [2024] 5 SCC 435 (SC).

*approach, especially when addressing minor defaults by smaller borrowers with limited resources. While the ruling favours creditors, it presents significant challenges for personal guarantors, including promoters and directors, whose assets may now be at risk in insolvency proceedings. The impact of this decision on settlement options and the protection of guarantors' rights will be key considerations as the legal landscape evolves".*²² The ruling supports the need to boost credit and lending to recharge the economic engine. However, the increased risks for guarantors may lead to a more cautious stance on offering personal guarantees. Striking a balance between the interests of creditors and guarantors is critical for economic development. In contrast to India's creditor-friendly framework under the IBC, both the United States and the United Kingdom have increasingly adopted a debtor-centric approach, prioritizing the protection and rehabilitation of distressed businesses.

III. COMPARATIVE ANALYSIS OF INSOLVENCY LAWS: THE TREATMENT OF PERSONAL GUARANTORS IN INDIA, THE US, AND THE UK

Countries like the US and the UK have also enacted codes for insolvency and bankruptcy which are the Bankruptcy Code²³ in the US and the Insolvency Act 1986²⁴ in the UK. There are major differences between all the three codes. The most significant difference is that the code in India is made to favour the creditor. Meanwhile, the US follows the 'debtor in possession' approach, and after the enactment of Corporate Insolvency and the

²² Indulia B and Ridhi, 'Upholding the Validity of Provisions Related to Personal Guarantors under IBC - Good for Lenders, Bad for Guarantors' (*SCC Times*, 3 January 2024) <<https://www.scconline.com/blog/post/2024/01/03/upholding-the-validity-of-provisions-related-to-personal-guarantors-under-ibc-good-for-lenders-bad-for-guarantors/>> accessed 15 October 2024.

²³ U.S. Bankruptcy Code 1978.

²⁴ Insolvency Act 1986.

Governance Act, 2020²⁵ the UK also shifted to a debtor-centric approach. In the ‘Debtors in Possession’,²⁶ the control of the assets remains under the debtor's control even when insolvency proceedings have been initiated against him, whereas it is quite the opposite in the ‘creditor in control’ approach.

A. Definitions

There are interpretational differences among three countries for the term ‘personal guarantor’. In IBC Section 5(22)²⁷ it is defined as “*an individual who acts as the surety in a contract of guarantee to a corporate debtor.*” In the US and the UK, there is no specific provision that defines a personal guarantor for a corporate debtor. In US law the term is defined broadly as a ‘guarantor’ *which is the person who is secondarily liable for another’s debt.*”²⁸ A definition similar to this is prevalent in British legislation. The term guarantor in the US and UK also includes guarantors who are sureties for a corporate entity in a contract.

B. Extent of Liability

The liability of the personal guarantors in the US remains largely based on the contracts that they have entered with the surety. If the contract is silent on the fact, then the court will decide the extent of the liability categorised as either limited liability or absolute liability. There is no cap on the amount that the guarantor has to pay in the latter and the former are those under which there are limitations on the extent of the liability of the guarantor. “*The most common limitations of the guarantor’s liability are contingent guarantees,*

²⁵ Corporate Insolvency and the Governance Act 2020.

²⁶ Priyanshu Fauzdar, “IBC Laws - Comparative Analysis of the Two Insolvency Framework Models, i.e., ‘Creditor-in-Control’ and ‘Debtor-in-Possession’ ” (*IBC Laws*, 24 July 2023) <<https://ibclaw.in/comparative-analysis-of-the-two-insolvency-framework-models-i-e-creditor-in-control-and-debtor-in-possession-priyanshu-fauzdar/>> accessed 13 October 2024.

²⁷ The Insolvency and Bankruptcy Code 2016.

²⁸ Henkel C, “Personal Guarantees and Sureties between Commercial Law and Consumers in the United States” [2014] 62 AJCL 333.

which may include the guarantee of collection or payment.”²⁹ Under Chapter 7³⁰ of the Bankruptcy Code, there is a distinction between the bankruptcy of the guarantor and the principal debtor. The code further states that both guarantor and debtor can file for bankruptcy. Debts are discharged only for the filing party, and if both parties want their debts to be discharged, they have to file for insolvency. Chapter 11³¹ of the code, states that the guarantors are still liable for corporate debts even if the company has restricted its debts. Personal guarantors' liability remains largely strict, and the guarantor remains fully liable unless they file for bankruptcy.

The UK has an Insolvency Act, 1986, that deals with the procedures under which a personal guarantor can file for insolvency and discharge his liability. There is another option available to personal guarantors in the UK, which is an Individual Voluntary Arrangement, which allows them to negotiate a repayment plan with creditors over some time. This can protect the guarantor from legal action, but only if creditors agree. In the UK the liability of the personal guarantor remains largely to the extent of his contract.

In India, the debt recovery systems are stricter as the creditor has been given more power under the IBC. The liability of personal guarantors of the corporate debtor is largely co-extensive as explicitly provided under section 128 of the Indian Contract Act, 1872.³² The SC clarified this in the case of, *Lalit Kumar Jain v. Union of India*³³ stating “*It is, therefore, clear that the sanction of a resolution plan and finality imparted to it by Section 31 does not per se operate as a discharge of the guarantor’s liability*”. This shows that

²⁹ Henkel C, “Personal Guarantees and Sureties between Commercial Law and Consumers in the United States” [2014] 62 AJCL333.

³⁰ U.S. Bankruptcy Code 1978, s 701-784.

³¹ U.S. Bankruptcy Code 1978, s 1100-1174.

³² Indian Contract Act 1872, s 128.

³³ *Lalit Kumar Jain v. Union of India* [2021] 9 SCC 321 (SC).

legislation and courts in India favour creditors when it comes to the recovery of debt.

C. Right to Subrogation

Indian courts in the case of *Lalit Mishra and Others v. Sharon Bio Medicine Ltd*³⁴, held that guarantors cannot enforce their rights of subrogation under the IBC because this can only be given under recovery proceedings. Supreme Court reiterated this view in the *Committee of Creditors of Essar Steel Ltd. vs Satish Kumar Gupta*.³⁵ Though IBC does not completely override the choice of the personal guarantors to sue for their rights under the doctrine of subrogation, still, no remedy remains open to the personal guarantor after the resolution plan is accepted.

The Bankruptcy Code in the US explicitly talks about the right of subrogation under Section 506 to Section 509.³⁶ “Furthermore, Section 509 of the US Bankruptcy Code, is fairly mechanical in its application. The guarantor only has to establish that it is liable to the debtor on a claim made against the debtor by the creditor and that the guarantor has paid off that claim. Unlike the US, India does not have a statutory provision in the Code solely dedicated to the principle of subrogation”.³⁷

Indian courts envisage the revival of a company and the rehabilitation of assets rather than the guarantor’s rights. This claim stems from the misunderstanding of the personal interest of guarantors, which has been reflected in corresponding court decisions ignoring the latter’s rights. Denial

³⁴ *Lalit Mishra v. Sharon Bio Medicine Ltd* [2018] SCC OnLine NCLAT 669 (SC).

³⁵ *Essar Steel India Ltd. Committee of Creditors v. Satish Kumar Gupta* [2020] 8 SCC 531 (SC).

³⁶ U.S. Bankruptcy Code 1978, s 506-509.

³⁷ Sampriti & Sugi Malati Murmu, “Subrogation Rights of Personal Guarantor: A Comparative Analysis” (*NUALS Law Journal*, 29 June 2021) <<https://nualslawjournal.com/2021/06/29/subrogation-rights-of-personal-guarantor-a-comparative-analysis/>> accessed 13 October 2024.

of guarantor rights can deter other individuals from offering personal guarantees in the future, cause problems for companies to mobilize funds, and hamper any economic development.

While insolvency and bankruptcy laws across the US, UK, and India share some similar concepts, the treatment of personal guarantors shows some differences, particularly in the extent of liability and rights of subrogation. The US and UK tend to adopt a more debtor-centric approach, offering personal guarantors broader protections and options, such as the right to negotiate repayment plans or discharge liability through voluntary arrangements and subrogation. In contrast, India's IBC leans heavily in favour of creditors, imposing stricter liability on guarantors.

IV. EVOLVING DYNAMICS OF PERSONAL GUARANTOR LIABILITY: INCONSISTENCIES AND CHALLENGES

The role of personal guarantors in insolvency proceedings has become increasingly important in India following the 2019 Amendment to the IBC, which allows creditors to pursue guarantors even after the resolution of corporate debt. This has led to a surge in litigation, as seen with over-recovery lawsuits. However, several challenges persist, including low recovery rates, the absence of provisions for asset tracing, ambiguities regarding liability after a guarantor's death, and cross-border insolvency

A. Rising Trend in Litigation against Personal Guarantor

NCLAT data shows lenders filed over 428 recovery lawsuits against personal guarantors in FY23. The claims total 35,765 cr. of dues, which shows a surge in the number of cases compared to previous years.³⁸ The NCLAT was

³⁸ Burugula P, "Surge in Personal Guarantor Cases under IBC in FY23" *Economic Times* (22 February 2023) <<https://economictimes.indiatimes.com/news/economy/finance/surge-in->

reluctant to admit the cases against guarantors because many promoters approached the SC challenging the constitutionality of the provisions of the 2019 Amendment, which brought personal guarantors under the ambit of insolvency proceedings, enabling creditors to pursue them for recovery even after the resolution of corporate debt. Before this amendment, personal guarantors were often able to shield themselves from liability, leaving creditors with limited options for recourse in case of defaults. SC upheld the provisions of the amendment further solidifying the position of creditors in pursuing recovery from personal guarantors. This judgment gave lenders additional confidence, as it confirmed that the personal guarantor's liability would persist despite the discharge of the corporate debtor. Consequently, creditors have increasingly turned to the National Company Law Appellate Tribunal for legal remedies, leading to a significant rise in the number of cases filed.

B. Low Recovery Rate

According to the IBBI, creditors have recovered only 2.16% of their admitted claims, amounting to ₹102.78 crore,³⁹ from personal guarantors under IBC, despite its potential to balance debtor relief with creditor recovery.

The data shows that of the 383 admitted personal guarantor insolvency cases, 124 have been closed, with only 26 repayment plans receiving approval have raised concerns about the low recovery rate, pointing out that a lack of scrutiny and weak enforcement of repayment plans could create a moral hazard, encouraging debtors to evade responsibility.

personal-guarantor-cases-under-ibc-in-fy23/articleshow/98160847.cms> accessed October 13, 2024.

³⁹ Chitravanshi R, "Only 2% Personal Guarantee Claims Recovered under IBC so Far: IBBI" *Business Standard* (21 May 2024) <https://www.business-standard.com/finance/news/creditors-recovered-2-of-claims-against-personal-guarantors-till-march-124052101110_1.html> accessed 13 October 2024.

A significant improvement has been the IBBI's decision to allow the same insolvency professional to manage both the company and its guarantor's insolvency processes, promoting better coordination. However, the recovery mechanisms under alternative laws like the SARFAESI Act have proven time-consuming, often allowing personal guarantors to shield their assets.

C. Lack of Provisions for Asset Tracing

A notable inconsistency in the treatment of personal guarantors under the IBC is the absence of provisions that allow for the recovery of assets in cases of avoidance or fraudulent transactions. Although such mechanisms exist for corporate debtors and individuals undergoing bankruptcy, they are notably missing for personal guarantors. This legal gap raises concerns about the potential diversion of assets before a resolution professional assumes control over the guarantor's estate.

Without the ability to reclaim assets that have been fraudulently transferred or otherwise diverted, the personal guarantor's estate could be significantly diminished, leaving creditors with fewer resources to recover. This shortfall in the law allows personal guarantors to transfer assets out of the reach of creditors, jeopardizing the fairness and effectiveness of the insolvency process.

D. Discharge of Liability

A trending legal debate regarding the duties of personal guarantors in situations where the underlying debt is discharged as part of the corporate debtor's resolution plan. Personal guarantors often try to escape liability by arguing that the resolution plan relieves them from their obligations, as the borrower's debt has been settled.⁴⁰ A recent ruling by the *State Bank of India*

⁴⁰ Jan, "Challenges Resolving Insolvencies of Personal Guarantors under IBC" (*LawAsia*, 21 June 2022) <<https://law.asia/resolving-insolvencies-personal-guarantors/>> accessed 13 October 13 2024.

v. Prashant Ruia,⁴¹ the Debts Recovery Tribunal (“DRT”) at Ahmedabad discussed this challenge. The DRT rejected an application to recover debt from a personal guarantor, citing the complete discharge of the corporate debtor's underlying liability under the resolution plan. This judgment was different from the judicial trend because it was accepted that the personal guarantor would not be set off from his liability even if the debt is repaid, but in this judgment, the DRT held that it can be set off if the debt is transferred to a third party.

While creditors generally retain the right to enforce personal guarantees even if the corporate debtor’s obligations are extinguished by law, complexities arise when debt assignments or transactions result in repayment through cash or other means, such as capitalization. In these cases, the discharge of the underlying debt may impact the creditor’s ability to pursue claims against the guarantor. If the assignee of the debt has been repaid under the terms of the resolution plan, creditors may face obstacles in recovering from the guarantor, as the fundamental basis for the guarantee—the underlying debt—no longer exists. This problem needs to be addressed by the courts and the legislature.

E. Cross-Border Insolvency

The citizenship of a personal guarantor holds little significance under the IBC. Insolvency proceedings are initiated in the jurisdiction where the corporate debtor or guarantor is located, irrespective of their citizenship. Despite this, many personal guarantors try to escape their obligations by fleeing the country and getting foreign citizenship.

⁴¹ Prashant Shashi Ruia v. SBI, (2021) SCC OnLine Guj 3056 (HCG).

In the case of *Sudip Dutta v. State Bank of India*,⁴² the NCLAT held that getting foreign citizenship does not discharge a personal guarantor of their financial dues. The tribunal stated that a guarantor cannot escape their dues merely by relocating or renouncing their citizenship. This interpretation upholds the principle that statutes should be written in a manner that supports their intended function—ensuring that guarantors cannot exploit legal gaps to avoid their obligations.⁴³

However, a significant gap remains in the IBC regarding cross-border insolvency. While the IBC treats domestic and foreign creditors equally, there is a lack of comprehensive legal provisions governing cross-border insolvency, especially in cases where creditors or guarantors are located outside India. This is especially pertinent in multinational corporate structures where Indian companies often serve as guarantors to foreign creditors. The lack of a strong cross-border insolvency framework complicates matters when creditors seek to enforce their claims across borders, as the enforcement of judgments or recovery of assets outside India remains challenging. Without a proper framework to handle such cross-border insolvency situations, personal guarantors could still find ways to escape their liability in other countries.

F. Liability after Death of the Guarantor

A critical emerging issue in the insolvency framework is whether legal heirs are liable for the personal guarantor's obligations after their death. This matter was recently examined in the case of *Bank of Baroda vs. Divya Jalan*,⁴⁴ where the appellants approached NCLT to recover dues from the legal heirs

⁴² *Sudip Dutta v. SBI* [2022] SCC OnLine NCLAT 4264 (NCLAT).

⁴³ K M Thomas and Ananya Arun, "IBC Laws - Personal Guarantors - Liability beyond Death and Borders: An Analysis of the Legal Position of a Guarantor upon Death and Change of Citizenship –" (*IBC Laws*, 26 August 2022) <<https://ibclaw.in/personal-guarantors-liability-beyond-death-and-borders-an-analysis-of-the-legal-position-of-a-guarantor-upon-death-and-change-of-citizenship-by-k-m-thomas-and-ananya-arun/>> accessed 13 October 2024.

⁴⁴ *Bank of Baroda v. Divya Jalan* [2022] SCC OnLine NCLT 191 (NCLT).

of the personal guarantor based on a clause in the personal guarantee agreement. The clause specified that, upon the guarantor's death, the liability could extend to their heirs.

However, the tribunal, after examining Section 5(22)⁴⁵ of the IBC, held that personal guarantors are defined as individuals who act as sureties in contracts of guarantee for corporate debtors. Importantly, the tribunal noted that neither Section 5(22) nor the related regulations include legal heirs within the definition of a personal guarantor.⁴⁶

In its ruling, the tribunal invoked Section 238⁴⁷ of the IBC, which grants the Code overriding authority over conflicting contracts or laws. As a result, the tribunal concluded that legal heirs cannot be held liable for the personal guarantor's obligations under the IBC, even if a contract states otherwise. This case highlights an uncertainty on whether the legal heirs can be held liable for the dues of the personal guarantors.

V. STRENGTHENING THE PERSONAL GUARANTOR FRAMEWORK: POLICY REFORMS FOR A BALANCED INSOLVENCY REGIME

The ever-evolving dynamics of the personal guarantors to a corporate debtor have led to an Amendment to the IBC. Despite this, there remain large loopholes in the mechanism that make way for the wrongdoing on the part of either the guarantor who wants to dispose of his liability illegally or a creditor who wants to overuse his powers. These suggestions are wide-ranging from

⁴⁵ Insolvency and Bankruptcy Code 2016, s 5(22).

⁴⁶ K M Thomas and Ananya Arun, "IBC Laws - Personal Guarantors - Liability beyond Death and Borders: An Analysis of the Legal Position of a Guarantor upon Death and Change of Citizenship" (*IBC Laws*, 26 August 26 2022) <<https://ibclaw.in/personal-guarantors-liability-beyond-death-and-borders-an-analysis-of-the-legal-position-of-a-guarantor-upon-death-and-change-of-citizenship-by-k-m-thomas-and-ananya-arun/>> accessed 13 October 2024.

⁴⁷ Insolvency and Bankruptcy Code 2016, s 238.

drafting a clear policy on the death of a guarantor, also addressing a need for a different tribunal that would deal with mostly guarantor cases, and cooperating with foreign countries to fight cross-border insolvency.

A. Clear Legal Provisions for the Death of a Personal Guarantor

The IBC is silent on the matter of handling the liability of a personal guarantor after their demise. There is a current debate going on about whether legal heirs can be held liable for the liabilities of the deceased guarantor. Supreme Court in the matter titled *Vinayak Purushottam Dube (Deceased), versus Jayashree Padamkar Bhat & Ors*⁴⁸ gave a verdict stating that an estate cannot be held liable for the default of a deceased. The same was reiterated by NCLAT *Alchemist Asset Reconstruction Company versus Deepak Puri*.⁴⁹ Despite this, there is a different opinion of some NCLTs on this and to prevent uncertainties and disputes, there should be an explicit provision clarifying how the deceased guarantor's estate will be treated in ongoing insolvency proceedings. The government can consider implementing laws that seamlessly transfer liability to the guarantor's estate, along with clear timelines for creditors to make claims.

B. Provision for Off-Court Settlements

One of the greatest drawbacks of IBC has been that it puts a lot of burden on the NCLTs of different states and it can be seen with the ever-increasing backlog of cases in NCLTs. The solution to this problem could be providing off-court settlement mechanisms to the creditors and the debtors who are willing to cooperate. In, *Lokhandwala Kataria Construction Pvt. Ltd.*

⁴⁸ *Vinayak Purushottam Dube v. Jayashree Padmakar Bhat* [2017] SCC OnLine SC 2202 (SC).

⁴⁹ *Alchemist Asset Reconstruction Co. Ltd. v. Deepak Puri* [2021] SCC OnLine NCLT 22414 (NCLT).

v. Nisus Finance and Investment Managers LLP,⁵⁰ the SC held that the IBC is a tool for debt recovery but off-court settlement can be used, if the parties are satisfied.⁵¹ The report of IBBI⁵² advocated for these reforms but are yet to be enacted by the legislature.

Introducing an Individual Voluntary Arrangement model, like that used in the UK, An IVA is a legally binding agreement in which a debtor commits to repaying a portion or all of their debts to creditors over a period, typically under terms favorable to the debtor. This could also bring considerable advantages to India's framework if adapted thoughtfully to its legal and financial landscape and could allow personal guarantors to negotiate flexible repayment plans with creditors outside of formal insolvency proceedings. For the UK's debtor-centric system, which prioritizes helping individuals regain financial stability, IVAs are a natural fit and are already widely used. The flexibility of an IVA aligns well with the UK's focus on protecting debtors from excessive creditor pressure. IVAs allow debtors to repay a manageable portion of their debt, often reducing the total owed, and enable them to avoid the stigma and severe consequences associated with bankruptcy.

In India's creditor-centric system, which emphasizes the rights and interests of creditors in debt recovery, IVAs could be a powerful tool for increasing debt recovery rates. Since an IVA encourages debtors to repay as much as they are able rather than defaulting entirely or declaring bankruptcy, creditors may recover a larger portion of the owed amount than through

⁵⁰ Lokhandwala Kataria Construction Pvt. Ltd. v. Nisus Finance & Investment Manager LLP 2017 SCC OnLine NCLAT 406 (NCLAT).

⁵¹ Aayush Mitruka "Supreme Court on Settlement of Insolvency Proceedings" (*IndiaCorpLaw*, 29 July 29 2017) <<https://indiacorplaw.in/2017/07/supreme-court-on-settlement-of.html>> accessed 15 October 15 2024.

⁵² "Framework for Use of Mediation under the Insolvency and Bankruptcy Code, 2016".

liquidation, where assets are often sold below value. This could reduce the burden on the courts and lead to better-negotiated settlements, which would save a lot of time and resources.

C. Establishing a Guarantor-Friendly Subrogation Framework

To match with international standards, India should make clearer provisions for subrogation rights which are mentioned in S506 TO S509⁵³ of the Bankruptcy Code of the US, which clearly defines the right of subrogation meanwhile, it has been present in India as a common law principle. Incorporating it into law would give guarantors the power to recover the dues from the corporate debtor after fulfilling their duties to creditors. The right of subrogation, allowing the guarantor to take the position of a guarantor after the dues are paid, is limited to the extent of the payment made by the guarantor. The Supreme Court upheld the decision of the NCLAT in *Kanwar Raj Bhagat vs. Gujarat Hydrocarbons and Power SEZ Ltd.*⁵⁴ This would incentivize personal guarantors to settle their dues, knowing that they can later pursue the debtor for recovery, thus creating a more just and equitable system.

D. Creating a Specialized Tribunal for Guarantor-Related Disputes

There has been a significant problem of jurisdiction overlapping of insolvency proceedings under the IBC, particularly regarding personal guarantors of corporate debtors. Section 60⁵⁵ of the IBC assigns the NCLT as the primary adjudicating authority for both corporate debtors and their personal guarantors. However, this has led to a procedural ambiguity due to the potential involvement of the DRT for individual insolvencies.⁵⁶ The

⁵³ U.S. Bankruptcy Code 1978, s 506-509.

⁵⁴ *Kanwar Raj Bhagat v. Gujarat Hydrocarbons & Power SEZ Ltd* [2021] SCC OnLine NCLAT 157 (NCLAT).

⁵⁵ Insolvency and Bankruptcy Code 2016, s 60.

⁵⁶ Shivam Singhal, "To File or Not to File: Understanding the Jurisdictional Dilemma in Personal Guarantor's Insolvency Resolution Process" (*SCC Times*, 21 February 2022)

conflicting jurisdictions between these tribunals not only create operational inefficiencies but also slow the resolution process, complicating the path to justice for all parties involved.

Initially, Section 60(2)⁵⁷ of the IBC mandated that the insolvency proceedings for personal guarantors be heard before the NCLT, especially when a corporate insolvency process was already underway. However, this has led to legal challenges from personal guarantors, who argue that if no corporate insolvency is pending, the DRT should retain jurisdiction.⁵⁸ Recent rulings, notably by the Supreme Court in the *State Bank of India v. Mahendra Kumar Jajodia*⁵⁹ case, have clarified that the NCLT is the appropriate venue even when no corporate insolvency proceedings are active. Yet, this decision remains contested, with critics citing concerns over due process and natural justice, particularly regarding the appointment of resolution professionals without adequate opportunity for the guarantor's input.

The jurisdictional confusion can be solved by a clearer, more systematic framework. Establishing a specialized tribunal or a special court dedicated exclusively to handling insolvency cases. Such a tribunal could provide the necessary expertise to handle the nuances of both corporate and personal insolvency, allowing for a cohesive application of the IBC across cases and ensuring more consistent and timely outcomes.

By centralizing the jurisdiction in a specialized court, India's insolvency framework could more effectively uphold the principles of natural

<<https://www.sconline.com/blog/post/2022/02/21/understanding-the-jurisdictional-dilemma-in-personal-guarantors-insolvency-resolution-process/>> accessed 14 October 2024.

⁵⁷ Insolvency and Bankruptcy Code 2016, s 60(2).

⁵⁸ Saurav Panda "Challenges Resolving Insolvencies of Personal Guarantors under IBC" (*Shardul Amarchand Mangaldas & Co*, 27 June 2022) <<https://www.amsshardul.com/insight/challenges-resolving-insolvencies-of-personal-guarantors-under-ibc/>> accessed 14 October, 2024.

⁵⁹ SBI v. Mahendra Kumar Jajodia [2022] SCC OnLine NCLAT 58 (NCLAT).

justice while expediting the resolution process. This would not only benefit creditors seeking redress but also maintain fairness for personal guarantors, fostering a balanced, predictable insolvency landscape.

E. Introduction of Cross-Border Insolvency Provisions

India doesn't have robust mechanisms to deal with Cross-Border Insolvency. The Indian courts face this problem because they have to implement older precedents in recent insolvency cases in India, involving companies with assets and creditors abroad, which have highlighted the need for clear cross-border insolvency laws. A historical case from 1908, *P. MacFadyen & Co.*,⁶⁰ In re, demonstrated early cross-border cooperation between English and Indian courts, but India's current legal framework lacks the structured regulations needed to address the complexities of modern global insolvency cases effectively. There exists a universal guide to insolvency laws which was prescribed by the UN in 1997 and the government can make law on the lines of this UNCITRAL Model Law.⁶¹ *"The Model Law seeks to provide a uniform approach to cross-border insolvency proceedings by harmonizing national insolvency laws dealing with it. It does not provide for substantive unification of insolvency laws, rather it respects the diversity found in the laws relating to insolvency of various jurisdictions and allows the States to draft their national laws in consonance."*⁶² After making a uniform law for the country the government may consider signing MOUs regarding the trial and extradition of offenders with some countries where they try to escape

⁶⁰ In re *P. Macfadyen & Co. Ex parte Vizianagaram Co. Ltd.*, [1908] 1 K.B. 67.

⁶¹ UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment and Interpretation, (Model Law with Guide) 1997.

⁶² Editor_4, "India's Tryst with Cross-Border Insolvency Law: How Series of Judicial Pronouncements Pave the Way?" (*SCC Times*, 16 April 2021) <<https://www.scconline.com/blog/post/2021/04/16/cross-border-insolvency-law/>> accessed 15 October 2024.

VI. CONCLUSION

The IBC 2016, particularly after the 2019 Amendments, has introduced a stricter framework for holding personal guarantors accountable for corporate debts. The inclusion of personal guarantors in insolvency proceedings, which can be initiated concurrently with corporate debtors, significantly strengthens the position of creditors. However, this creditor-centric approach raises an important question about the fairness and sustainability of the insolvency regime, especially for personal guarantors.

The Indian judiciary through landmark judgments such as *Lalit Kumar*⁶³ and *V. Ramakrishnan*,⁶⁴ has reinforced the liability of personal guarantors, making it clear that their obligations persist even after corporate debts are resolved. This stands in stark contrast to the debtor-centric insolvency frameworks in the U.S. and U.K., where personal guarantors are afforded more protection through mechanisms like voluntary repayment plans and the right to subrogation. India's legal framework, while efficient in debt recovery, places personal guarantors under significant pressure, often exposing them to full liabilities even after the corporate debtor's resolution.

One of the major challenges in the framework dealing with personal guarantors is the low recovery rate from personal guarantors, which, according to recent reports, stands at just 2.16%. This indicates systemic inefficiencies in the enforcement and monitoring of debt repayment plans, as well as a lack of robust mechanisms to trace and reclaim assets that have been fraudulently diverted. Additionally, the absence of clear provisions regarding asset tracking and the death of guarantors presents challenges, especially in cases involving

⁶³ *Lalit Kumar Jain v. Union of India* [2021] 9 SCC 321 (SC).

⁶⁴ *SBI v. V. Ramakrishnan* [2018] 17 SCC 394 (SC).

cross-border insolvency, where there are few legal frameworks in place to pursue guarantors or assets located outside India.

The study also raises concerns about the potential abuse of power by creditors and the need for more balanced legal provisions. As personal guarantors face increasing risks, particularly after the Amendments, there is a growing need for reforms that could mitigate excessive creditor control and provide guarantors with better options for settling their liabilities. Proposals such as the establishment of a specialized tribunal for personal guarantor disputes, clearer subrogation rights, improved asset recovery mechanisms, and clearer provisions on cross-border insolvency would help create a more just and equitable insolvency regime.

Conclusively, while the IBC has proven effective in speeding up the insolvency process and enhancing recovery rates, there is still a long way to go in addressing the concerns of personal guarantors. Strengthening legal protections for guarantors and incorporating global best practices will ensure that the Indian insolvency regime is both efficient and fair.