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Mortgage, Guarantee and Covenant to Pay under the Insolvency and Bankruptcy Code: A Doctrinal Reassessment of Financial Debt

HIMANSHU MAHESHWARI[1]

ABSTRACT

The purpose of this research article is to provide a legal review of the meaning of "financial debt" as stated in the Insolvency and Bankruptcy Code, 2016 by examining how mortgages, guarantees and obligations related to payment all work together with respect to creditors. Further, it discusses the significant role that a creditor's classification plays in the operational structure of the Committee of Creditors through their determination or interpretation of the term "financial debt" within Section 5(8) of the Code with an emphasis on the "disbursement" requirement related to time value of money. The research compares the development/judicial history (the judicial evolution) of this interaction between financial debt through case law where creditors defined financial debt narrowly (but excluded from this definition all types of secured loans) when a corporate debtor only serves as a third-party mortgagor (the corporate debtor). The article explains how transactions where no actual loan was provided, no actual financial accommodation was made to a corporate debtor and, therefore, do not fulfil the basic requirements of financial debt have been determined previously to not be financial debt. Nevertheless, this understanding has been refined through subsequent case law, where courts ultimately applied a more substantiated/realistic interpretation in their analysis of financial debt. At the same time, this raises concern about potentially creating ambiguity between secured and financial creditors. In conclusion, the article proposes that a systematic and principled approach (i.e. based on the nature of the obligation, intention of the parties involved, and overall transactional structure) should be employed in order to provide for doctrinal clarity and consistency in relation to insolvency matters.

Keywords: *Insolvency and Bankruptcy Code, Corporate Guarantee, Covenant to Pay, Financial Debt*

I. INTRODUCTION

Insolvency and Bankruptcy Code, 2016 (IBC) represents a fundamental restructuring of India's insolvency framework, placing creditor classification at the centre of the resolution process.

[1] Author is a Student at Guru Gobind Singh Indraprastha University, Delhi, India.

Among the various categories of creditors recognised under the Code, the position of a "financial creditor[2]" is uniquely significant, as it determines participation and voting power in the Committee of Creditors. The definition of "financial debt" under Section 5(8) of the code, therefore, assumes a pivotal role in shaping the architecture of insolvency proceedings. While the statutory language appears expansive, judicial interpretation has repeatedly emphasised certain core elements—most notably, the requirement of disbursement against the consideration for the time value of money.

However, the application of this definition has become increasingly complex in the context of modern financing arrangements, particularly where corporate debtors are involved not as direct borrowers but as providers of security for third-party obligations. Such arrangements raise a difficult question: Can a creditor, who has not directly disbursed funds to the corporate debtor but holds security over its assets, be regarded as a financial creditor? The answer to this question has evolved through a series of judicial pronouncements, beginning with the restrictive approach adopted by the Supreme Court in Anuj Jain Interim Resolution Professional for Jaypee Infratech Limited Versus Axis Bank Limited Etc (Anuj Jain v. Axis Bank Ltd)[3]and subsequently nuanced by later decisions.

At the heart of this evolving jurisprudence lies the legal significance of a "covenant to pay." Traditionally viewed as a standard contractual clause within security documents, such covenants are now being scrutinised to determine whether they create an independent obligation akin to a guarantee. This shift reflects a broader transition insolvency law from a formalistic understanding of transactions to a more substantive analysis of their economic and legal effects.

This article seeks to examine the doctrinal interplay between mortgage, guarantee, and covenant to pay within the framework of the IBC. It argues that while a mortgage simpliciter does not constitute financial debt, the presence of an express covenant imposing personal liability—particularly liability for deficiency—may transform the transaction into one that satisfies the requirements of Section 5(8). At the same time, it emphasises the need for a principled approach to avoid over-expansion of the category of financial creditors.

II. THE STATUTORY ARCHITECTURE OF FINANCIAL DEBT

The definition of financial debt under Section 5(8) of the IBC is both inclusive and structured. It begins with a principal clause requiring that a debt must be disbursed against the consideration for the time value of money, followed by an illustrative list of transactions in sub-clauses (a) to

[2] Section 5(7) of IBC

[3](2020) 8 SCC 401

(i). The Supreme Court has consistently held that the essential elements of disbursement and time value of money cannot be ignored even when a transaction falls within one of the enumerated categories.

In Anuj Jain v. Axis Bank Ltd., the Court further expounded the ratio laid by a three judge bench in Pioneer Urban [4]by observing that:

> "*Any of the transactions stated in the said sub- clauses (a) to (i) of Section 5 (8) would be falling within the ambit of 'financial debt' only if it carries the essential elements stated in the principal clause or at least has the features which could be traced to such essential elements in the principal clause. In yet other words, the essential element of disbursal… against the consideration for time value of money needs to be found in the genesis of any debt before it may be treated as 'financial debt'*"[5]

This formulation underscores that the definition cannot be interpreted in a manner that renders its core requirements redundant. Even where a transaction appears to fall within sub-clauses such as guarantees or indemnities, it must still be traceable to the foundational concept of financial accommodation.

The importance of this approach was reaffirmed in Global Credit Capital Ltd. v. Sach Marketing Pvt. Ltd.[6], where the Supreme Court emphasised that the categories listed in Section 5(8) must satisfy the test laid down in the principal clause, namely disbursement against time value of money.

This doctrinal consistency has ensured that the definition of financial debt remains anchored in its economic rationale, rather than expanding into an open-ended category.

III. MORTGAGE UNDER PROPERTY LAW: NATURE AND LIMITS

A **mortgage**[7], as defined under Section 58 of the Transfer of Property Act, 1882 (TPA), is a transfer of an interest in immovable property for the purpose of securing the payment of a debt. Its essential characteristic is that it creates a security interest in property, rather than an independent obligation to pay. The mortgagor may or may not be personally liable, depending

[4] Pioneer Urban Land and Infrastructure… Versus Union of India (2019) 8 SCC 416

[5] Supra note 2, para 43

[6] 2024 SCC OnLine SC 649, para 20 (b)

[7] Section 58 of TPA: "Mortgage", "mortgagor", "mortgagee", "mortgage-money" and "mortgage-deed" defined.—(a) A mortgage is the transfer of an interest in specific immoveable property for the purpose of securing the payment of money advanced or to be advanced by way of loan, an existing or future debt, or the performance of an engagement which may give rise to a pecuniary liability.
The transferor is called a mortgagor, the transferee a mortgagee; the principal money and interest of which payment is secured for the time being arc called the mortgage-money, and the instrument (if any) by which the transfer is effected is called a mortgage -deed.

on the nature of the mortgage and the terms of the instrument.

In a **simple mortgage**[8], the mortgagor binds himself personally to pay the mortgage money, but the primary remedy of the mortgagee remains against the property. In an **English mortgage**[9], there is both a transfer of property and a personal covenant to repay. However, even in such cases, the mortgage is fundamentally a device for securing repayment, not for creating a primary borrowing relationship.

The distinction becomes more complex in cases where the mortgage is created not by the borrower but by a third party. In such situations, the mortgagor provides security without necessarily incurring personal liability. The legal question then arises whether such an arrangement can be treated as giving rise to a financial debt under the IBC.

IV. Guarantee under contract law

A guarantee[10], as defined under Section 126 of the Indian Contract Act, 1872 (Contract Act), involves a tripartite relationship between the creditor, the principal debtor, and the surety. The defining feature of a guarantee is the existence of a secondary obligation, whereby the surety undertakes to discharge the liability of the principal debtor in the event of default.

Section 128 further provides that the liability of the surety is co-extensive with that of the principal debtor, unless otherwise provided by contract. This means that the creditor may proceed against the surety without first exhausting remedies against the principal debtor.

Under the IBC, guarantees are explicitly included within the definition of financial debt. Section 5(8)(i) refers to "any liability in respect of any of the guarantee or indemnity," thereby recognising that a guarantor may be treated as a financial debtor even in the absence of direct disbursement.

V. The supreme court's approach in Anuj Jain

The decision in Anuj Jain v. Axis Bank Ltd. marks a foundational moment in the interpretation

[8] (b) Simple mortgage.—Where, without delivering possession of the mortgaged property, the mortgagor binds himself personally to pay the mortgage-money, and agrees, expressly or impliedly, that, in the event of his failing to pay according to his contract, the mortgagee shall have a right to cause the mortgaged property to be sold and the proceeds of sale to be applied, so far as may be necessary, in payment of the mortgage-money, the transaction is called a simple mortgage and the mortgagee a simple mortgagee.

[9] (e) English mortgage.—Where the mortgagor binds himself to re-pay the mortgage-money on a certain date, and transfers the mortgaged property absolutely to the mortgagee, but subject to a proviso that he will re-transfer it to the mortgagor upon payment of the mortgage-money as agreed, the transaction is called an English mortgage.

[10] Section 126 "Contract of guarantee", "surety", "principal debtor" and "creditor".—A "contract of guarantee" is a contract to perform the promise, or discharge the liability, of a third person in case of his default. The person who gives the guarantee is called the "surety"; the person in respect of whose default the guarantee is given is called the "principal debtor", and the person to whom the guarantee is given is called the "creditor". A guarantee may be either oral or written

of “Deed of mortgage”as a financial debt under the IBC. The case involved mortgages created by the corporate debtor i.e. Jaypee Infratech Limited (JIL) to secure loans advanced to its holding company i.e. Jaiprakash Associates Limited (JAL). The lenders of the holding company claimed to be financial creditors of the corporate debtor on the basis of these mortgages.

The Supreme Court rejected this contention, holding that a mere security interest does not constitute financial debt. The Court observed that:

> *“47.2. Therefore, we have no hesitation in saying that a person having only security interest over the assets of corporate debtor (like the instant third party securities), even if falling within the description of ‘secured creditor’ by virtue of collateral security extended by the corporate debtor, would nevertheless stand outside the sect of ‘financial creditors’ as per the definitions contained in sub- sections (7) and (8) of Section 5 of the Code. Differently put, if a corporate debtor has given its property in mortgage to secure the debts of a third party, it may lead to a mortgage debt and, therefore, it may fall within the definition of ‘debt’ under Section 3(10) of the Code. However, it would remain a debt alone and cannot partake the character of a ‘financial debt’ within the meaning of Section 5(8) of the Code.”*

The Court further emphasised that the lenders had not disbursed any amount to the corporate debtor and that the transactions lacked the essential element of time value of money in relation to the corporate debtor.

This decision established a clear principle: a mortgage created to secure the debt of another does not, by itself, give rise to financial debt. The creditor in such a case may be a secured creditor, but not a financial creditor.

VI. The limits of the Anuj Jain doctrine

While Anuj Jain provides a clear rule, its application in practice has revealed certain limitations. Modern financial transactions often involve complex structures where multiple entities participate in financing arrangements. In such cases, the absence of direct disbursement to the corporate debtor does not necessarily mean that the debtor is not financially involved.

Moreover, the judgment in Anuj Jain was based on the specific facts of the case, where the corporate debtor had merely provided security without undertaking any additional obligation. The Court did not consider the effect of clauses that impose personal liability on the mortgagor.

Subsequent decisions have therefore sought to refine the doctrine by distinguishing between pure security arrangements and transactions involving additional obligations.

VII. Covenant to pay: nature and legal effect

“A covenant to pay is a legally binding promise in a contract where one party commits to pay a specified sum to another, often on demand or a fixed date, commonly seen in loan agreements, security documents, promissory notes, and deeds. It forms the primary obligation in debt instruments, ensuring the debtor (covenantor) repays principal, interest, or other liabilities to the creditor (covenantee). Covenant to pay directly enforces payment, surviving even if security is invalidated. It covers present/future debts, liabilities, or specified amounts; can be "all monies" clauses.”[11] To summarise, A covenant to pay is a contractual clause whereby a party undertakes to pay a specified sum or discharge a liability. In the context of mortgage deeds, such covenants often appear as standard provisions requiring the mortgagor to repay the mortgage debt or to cover any deficiency after enforcement of security.

The legal significance of such covenants depends on their scope and wording. If the covenant merely reiterates the existence of the underlying debt, it may not create an independent obligation. However, if it imposes a personal liability on the mortgagor to discharge the debt of another, it may assume the character of a guarantee.

The covenant to pay gains heightened significance under IBC, particularly in distinguishing financial creditors and enforcing claims during corporate insolvency resolution processes (CIRP). A covenant to pay in security documents like deeds of hypothecation or mortgages deed can transform a security provider or secured creditor into a financial creditor, if it includes an explicit promise to discharge liabilities i.e shortfalls.

VIII. The Supreme Court’s shift in China Development Bank[12]

The Supreme Court’s decision in China Development Bank v. Doha Bank[13] represents a significant development in this area. A case where four different entities of Reliance communication(RCom) including the Corporate Debtor jointly executed the Deed of hypothecation to create a charge over their property for securing the repayment of the facilities advanced by the China Development Bank. The RCom entities agreed to provide their assets as security and further undertook to pay any shortfall of debts owed by each of the RCom entities. All the RCom entities pooled their resources to provide security for the facilities availed by any of the entities, ensuring that each entity was individually liable to pay the debt of all the entities. The Court while examining a deed of hypothecation(DoH) which had a clause requiring the

[11] J.C. Flowers Asset Reconstruction Pvt. Ltd. Versus Vithal M. Dahake Resolution Professional of Radius Estate Projects Pvt. Ltd. Comp. App. (AT) (Ins) No. 1801 of 2024

[12] China Development Bank versus Doha Bank Q.P.S. C., (2025) 7 SCC 729

[13] Ibid

corporate debtor to pay any shortfall after enforcement of security. The Court held that “the latter part of clause 5(iii)of the DoH indicates that RITL-Corporate Debtor, who is not the borrower of the appellants, agreed to discharge the liability of the third parties (RCom and RTL) to the appellants in the case of default of RCom or RTL. Therefore, the second part of clause 5(iii) of the DoH amounts to a guarantee provided by the Corporate Debtor to the appellants in terms of Section 126 of the contract act. even if the document is styled as a security instrument.”

Adding on to it, court explicated that when clause (i) of Section 5(8)[14] is applicable, it is not necessary that the Financial Creditor actually tenders any amount to the Corporate Debtor The amount of any liability in respect of any of the guarantees for money borrowed against the payment of interest is a financial debt under Section 5(8) of the IBC

This reasoning marks a departure from the formal approach of Anuj Jain and introduces a more flexible framework based on the actual obligations undertaken by the parties.

IX. NCLAT AND EVOLVING JURISPRUDENCE

Tribunals have built upon this reasoning to develop a more nuanced approach. In several cases, it has been held that where a corporate debtor undertakes to repay the debt of another or to cover any deficiency, the transaction may be treated as financial debt.

At the same time, tribunals have cautioned that the mere presence of a covenant to pay is not sufficient. The clause must be examined in its context to determine whether it creates a genuine obligation or is merely incidental to the security arrangement[15].

X. RECONCILING COMPETING APPROACHES

The apparent conflict between Anuj Jain and China Development Bank can be resolved by recognising that they address different types of transactions. The former deals with mortgages simpliciter, while the latter concerns security documents containing substantive payment obligations.

The key distinction lies in whether the corporate debtor has assumed a personal liability. Where such liability exists, the transaction may be treated as a guarantee. Where it does not, the arrangement remains a security interest.

XI. COMMERCIAL EFFECT OF BORROWING

Another important factor is the concept of “commercial effect of borrowing” under Section

[14] Section 5(8)(i) the amount of any liability in respect of any of the guarantee or indemnity for any of the items referred to in sub-clauses (a) to (h) of this clause;

[15] Phoenix ARC Pvt. Ltd. versus Ketulbhai Ramubhai Patel AIR 2021 SC 875

5(8)(f). Courts have recognised that financial debt may arise even in the absence of direct disbursement[16], provided the transaction has the economic characteristics of borrowing[17].

> *"The statutory text of Section 5(8) of the Code does not mandate that disbursement must be made exclusively or directly to the Corporate Debtor. What the statute requires is disbursement against consideration for time value of money, not necessarily direct transfer into the Corporate Debtor's account. Accordingly, it can be held that direct disbursement to the Corporate Debtor is not a sine qua non. We may add that, however, this becomes a significant contributory factor to determine the actual nature of transaction between the Financial Creditor and the Corporate Debtor, which can vary from case to case as per its own peculiar facts."*[18]

In cases where the corporate debtor benefits from the loan or participates in its utilisation, the transaction may be regarded as having the commercial effect of borrowing. This approach aligns with the objective of the IBC to capture the economic substance of financial arrangements.

XII. Critical analysis

The shift toward a substance-based approach is both necessary and inevitable in the context of modern finance. However, it also raises concerns regarding over-expansion and uncertainty. If every covenant to pay is treated as a guarantee, the distinction between secured creditors and financial creditors may become blurred.

Supreme Court in China Development Bank had expressed that the nature of a document must be determined by its substance rather than its title, observing that:

"The name of the document is not decisive factor"[19]

SC in various cases before it have held that the nature of the document or transaction between the parties to the contract is to be read as a whole and is not to be determined by the nomenclature/title of a contract[20] and attempts should be made to harmonise the terms.[21] There is therefore a need for a structured test that considers:

- The nature of the covenant,
- The intention of the parties,

[16] Maitreya Doshi v. Anand Rathi Global Finance Ltd. & Ors AIR 2022 SC 4595

[17] Rajeev Kumar Jain versus Uno Minda Limited 2024 SCC Online NCLAT 28

[18] Supra Note 10 para 70

[19] Para 53 of the judgment

[20] (2008) 4 SCC 451

[21] (2022) 4 SCC 657

- The extent of liability, and
- The overall structure of the transaction.

Such a test would ensure that the classification of creditors remains consistent and predictable.

XIII. Conclusion

The jurisprudence on mortgage, guarantee, and covenant to pay under the IBC reflects a dynamic interplay between statutory interpretation and commercial reality. While Anuj Jain established the limits of financial debt, subsequent decisions have expanded its scope by recognising the transformative potential of contractual covenants.

The emerging position suggests that a mortgage is no longer viewed in isolation but as part of a broader contractual framework. Where a covenant to pay imposes personal liability and aligns with the characteristics of a guarantee, the transaction may be treated as financial debt.

This development represents a move toward a more realistic and functional understanding of financial relationships under the IBC. At the same time, it underscores the importance of careful drafting and judicial interpretation in maintaining the balance between flexibility and certainty.

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