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# THE GLOBAL VACCINE RIDE: CLIQUE OF LEGAL REPUGNANCY?

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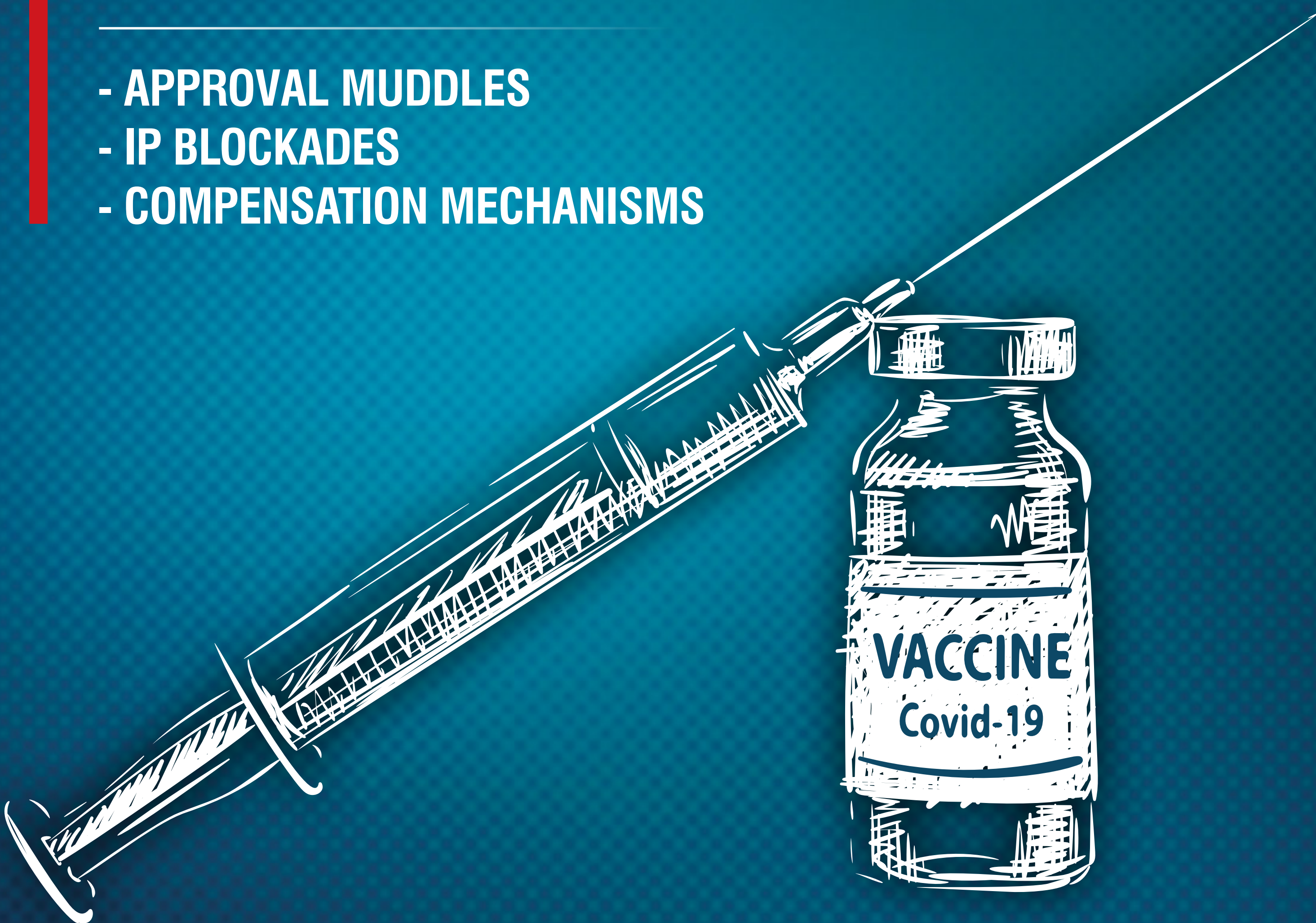

# Guarantor's Conundrum

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**Purusharth Singh**

The Supreme Court recently found itself in possession of the paintbrush that for centuries has been used to paint a series of tales depicting the blow-hot-blow-cold relationship between the creditor, the borrower and the guarantor. Recently, the relationship has been tested to its absolute limit, thanks to a series of grab-cash-and-dash stories that continue to rake in serious views on popular streaming sites.

Having decided it had spent enough time on the side-lines, the Supreme Court transferred a clutch of petitions from various High Courts to settle for once and all, the cantankerous issues surrounding creditors and guarantors or promoters of companies that have defaulted on loan repayments. Unfortunately, sordid tales of NPAs followed by flights to exotic locations are not the kind of news the already morose Indian investment climate deserves.

In the matter of Lalit Kumar Jain v. Union of India, the Apex court while upholding the constitutional validity of a 2019 notification that made the provisions of the Insolvency and Bankruptcy Code 2016 or IBC applicable to personal guarantors, corporate debtors and allowed creditors to move against personal guarantors under IBC to recover the debt. It held that the discharge of a debt owed by a company to its creditor, by operation of law or due to liquidation or insolvency proceeding, does not absolve the surety/guarantor of his or her liability since this liability arises out of an independent contract. Therefore, the ratification of a resolution plan does not automatically discharge a personal guarantor/promoter of his liabilities under the guarantee.

Will the verdict act as a deterrent for the unruly, delinquent borrowers or will it end up making the businessman loan shy? These are early days for the IBC in India and only time can tell.

Until recently, it was customary to expect a successful resolution of debts of a company to maintain status quo (by revising the construct of the financing arrangement). It used to imply that the debt has been reduced, creditors have taken a hit and life goes on.

However, these are challenging times. Most companies have been struggling. Creditors are facing the brunt of bad loans. With liquidity getting tighter, their position is even more vulnerable. The creditors merely want the promoters to contribute – either in the form of pledging and investing personal assets during debt resolution or by sharing a part of their personal assets (by invocation of personal guarantee).

It stands to reason that the guarantor while signing the guarantee document, which empowers the creditor to take away his personal assets in the event his company fails to repay its debts, was conscious of the inherent risks. If the promoter is the driving force behind his company and a guarantee is a standalone arrangement of its own, then it appeals to logic that with the company subject to a debt resolution process, the creditors should not be the only ones taking haircuts. All stakeholders have to swallow the bitter pill of having lost money and among the worst affected are the operational creditors.

Public perception so far has been that promoters, however, usually escape the torment of a bad haircut as personal securities are often invoked last to realise a portion of the bad debt by the creditors.

However, the twist lies in the question, 'should the sanction of a resolution per se operate as a discharge of the guarantor's liability?'

Section 62 of the India Contract Act, 1872 stipulates, "if the parties to a contract agree to substitute a new contract for it, or to rescind or alter it, the original contract need not be performed". The guarantors are not let off the hook easily under the IBC mandated CIRP process. The committee of creditors (CoC) restructure company/ corporate debtors' debts (albeit by intervention of a new management) where the value of settlement is often much lower than the fair value of the securities. The guarantor in such situations finds himself bound by the terms of settlement to which he has not consented and his contract of guarantee is not novated!

Right to subrogation (section 140 of the Indian Contract Act, 1872) stipulates that a guarantor is invested with all the rights which the creditor had upon the payment or performance of all that he was liable for. However, during the CIRP process, not only does the guarantor (usually the promoter/member/ shareholder of the corporate debtor) not receive anything for his personal contributions to the creditor resolution pool, he also does not get to enjoy the rights section 140 promises a guarantor, i.e. to recover from the corporate debt or at least a portion of the funds he has contributed.

In Adam Smith famous words, "it is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own self-interest". But what happens when the butcher, farmer, and the baker decide it's not worth the risk? Their enterprise keeps the world economy moving. For this reason, the recent order will hold tremendous sway in determining the direction this relationship takes, with economy on its heels.

The immediate implications may include promoters becoming loan wary. Other possibilities include, ushering in a new era of financing with tempered risks and better security. In an economy struggling to land on its feet, one can almost understand why the Hon'ble Supreme Court felt compelled to take matters in its own hands.

The solution to this crisis lies in the realisation that, unlike power, a zero sum game, commerce is positive sum game. After all, it was the risk and reward system that lured us out of the dark caves.

**Purusharth** is a Partner and part of the firm 's corporate advisory practice and focuses on Infrastructure Development & Management, Restructuring & Insolvency. He is a multidisciplinary lawyer with a rich experience of advising clients on a variety of complex commercial and financial transactions in this space.