Tune out the noise over haircuts under India's bankruptcy code

The Subhash Chandra personal-guarantee case reminds us of the need to make fine distinctions that too many observers miss



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When the Adjudicating Authority approved the first resolution plan for a corporate debtor under Part II of the Insolvency and Bankruptcy Code (IBC) on 2 August 2017, the hue and cry ran well ahead of the facts. It was the resolution plan of Synergies-Dooray Automotive Ltd (Dooray). The plan provided ₹55 crore for creditors against admitted financial claims of ₹972 crore, a haircut of 94%.

Nine years later, Part III of the IBC, dealing with personal insolvency, produced its first headline case. The sound is familiar, only louder. Claims of about ₹22,007 crore have been admitted against Subhash Chandra as personal guarantor, while the repayment plan before the Adjudicating Authority offers about ₹6 crore to creditors. Read mechanically against the admitted claims, that produces a haircut of more than 99%.

The comparison with *Dooray* is inevitable. But its lesson must not be forgotten: outcome cannot be divorced from economic reality. Dooray had a liquidation value of ₹8 crore when its insolvency commenced. The plan realized several times that value, though only 6% of the financial claims.

Let us be clear. Claims are not assets. They tell us what is owed; assets determine what can be paid. An insolvency process cannot distribute what the estate does not contain. The relevant question is therefore not how much is claimed, but what assets are available and what the process can reasonably realize from them. This distinction is particularly important in the case of a personal guarantor.

A guarantee is not the loan. It is a contingent obligation. It is invoked when the principal debtor defaults. The guarantor's liability is therefore not another loan sitting alongside the original debt. It is an additional source of recourse for the same underlying obligation. Importantly, a personal-guarantor insolvency process reaches the estate of the guarantor, not the estate of the principal debtor. A shortfall in the borrower's insolvency process and a shortfall in the guarantor's repayment plan therefore cannot simply be treated as two independent haircuts on the same debt.

Nor does a repayment plan for the guarantor extinguish the underlying debt. The lender's recourse against the principal debtor, its assets and securities, co-guarantors and other available sources of recovery remains relevant. The IBC permits proceedings against corporate debtors and personal guarantors and provides for coordination between them in appropriate circumstances.

The IBC is not a recovery law. It seeks rehabilitation of the personal guarantor through a repayment plan, which may incidentally yield some realization for creditors. Treating that realization as recovery is another error. A shortfall in recovery may be a haircut; a shortfall in a repayment plan's realization is not.

A personal guarantee is not collateral, equivalent to a mortgage or pledge. It gives the lender recourse to the guarantor's personal estate if the underlying borrowing goes wrong. Its value therefore depends on the guarantor's financial capacity, creditworthiness and conduct. Like the loan itself, a guarantee carries risk and needs to be assessed and priced accordingly.

A fundamental error is how claims and realizations are counted. Suppose a bank has lent ₹100 to a company and holds someone's personal guarantee for the same ₹100. If the company's insolvency process yields ₹30, the bank has recovered 30% of the ₹100 debt. This is a 70% haircut. Now suppose both the lender and guarantor submit claims of ₹100 in the company's insolvency process. The total claims become ₹200, even though the underlying debt is only ₹100. If the process still realizes ₹30, the same ₹30 is now 15% of admitted claims, producing an apparent haircut of 85%.

Now suppose the guarantor subsequently undergoes insolvency resolution and that process realizes ₹5. Viewed in isolation, the guarantor's process shows just 5% of a ₹100 claim realized, or a haircut of 95%. Thus, the same ₹100 underlying debt can produce three very different headline numbers: 70%, 85% and 95%. None is necessarily wrong for the particular process, but they are not three measures of economic loss.

None of this means that the present concerns should be dismissed. If the assets disclosed by a personal guarantor genuinely represent all that remains in the estate, that economic reality has to be accepted, however uncomfortable. But that proposition carries an equally important qualification: the process must be capable of determining whether the disclosed assets really are all that remains.

The Subhash Chandra case provides a useful opportunity to examine whether Part III has all the investigative, tracing and avoidance mechanisms that experience with corporate insolvency has shown to be necessary. If assets have been transferred, diverted or otherwise depleted, the law must effectively identify and recover them.

There is also a striking parallel with *Dooray*. There, creditors objected to the assignment of the debt of Synergies Castings, a related party, to Millennium Finance on the ground that it diluted the voting share of other creditors. Here, the concern is concentration: entities linked to the debtor's family together hold 62% of the voting share. Seen from opposite ends of the table, dilution then and concentration now raise the same question: was the body entitled to vote properly constituted? These legitimate process questions should be examined on the merits.

Dooray's 94% haircut became a controversy because the number was dramatic. But the number meant little without the asset base against which it was measured. Amendments and judicial experience could improve the process; they could not create value that the distressed company did not possess. The same is true of a personal guarantor. The value of a guarantee depends on what stands behind it. If assets have been concealed or improperly removed, the law must find and recover them. If they genuinely no longer exist, no insolvency process can manufacture them.

Part III is a young law and the present case warrants scrutiny. But there is a difference between strengthening the architecture of personal insolvency and faulting the law for an estate that contains little value.