SUPREME COURT RULES ON COMMERCIAL WISDOM OF CREDITORS TO ALLOW WITHDRAWAL OF INSOLVENCY PROCEEDINGS

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- Adjudicating authority cannot interfere with a decision of the committee of creditors to allow withdrawal of insolvency resolution process.
- If the committee of creditors unjustifiably or arbitrarily refuses withdrawal of insolvency resolution process, then the adjudicating authority can review and set aside such decision.

INTRODUCTION

In *Vallal RCK v M/s Siva Industries & Anr. (2022) ibclaw.in 63 SC*, the Supreme Court ("**SC**") has once again given precedence to the commercial wisdom of the committee of creditors ("**CoC**"). The issue before the SC was whether the Adjudicating Authority could interfere with the CoC's decision to allow withdrawal of insolvency proceedings on the basis of a settlement plan. The SC held that the adjudicating authority, while deciding an application under Section 12A of the Insolvency and Bankruptcy Code ("**Code**"), cannot review the merits of a settlement plan approved by the CoC.[1]

WITHDRAWAL OF INSOLVENCY PROCEEDINGS

Upon the commencement of insolvency proceedings, board of directors of the corporate debtor are suspended. Further, the promoters of the corporate debtor cannot seek to purchase the corporate debtor as a going concern under the insolvency process due to the eligibility criteria under Section 29A of the Code, which bars the promoters from participating in the insolvency process. Therefore, the only way available for promoters to regain control of the corporate debtor post initiation of insolvency proceedings is to offer a settlement plan and seek *withdrawal* of the insolvency proceedings.

Section 12A of the Code read with Regulation 30A of the CIRP Regulations allow withdrawal of insolvency proceedings in the following manner:

- Prior to constitution of the CoC: An application can be filed through the interim resolution professional without any requirement of consent of the creditors ("**Option 1**")
- After the constitution of the CoC: An application can be filed through the resolution professional only if 90% of the CoC has provided its consent ("**Option 2**")

Thus, for Option 2, the promoters must propose a settlement plan which is acceptable to 90% of the

creditors.

A withdrawal application can be filed even after the issuance of invitation for expression of interest by stating the reasons justifying withdrawal after issuance of such invitation.[2] In the present factual background, the Resolution Professional had filed an application seeking initiation of liquidation proceedings. However, the Supreme Court upheld the CoC's decision to approve withdrawal of the insolvency proceedings.

FACTUAL BACKGROUND

On July 04, 2019, an application was filed by IDBI bank to initiate the Corporate Insolvency Resolution Process ("**CIRP**") of M/s Siva Industries and Holdings Limited ("**Corporate Debtor**") under Section 7 of the Code[3]. A Resolution Plan was proposed, which plan failed to meet the requisite threshold of approval by the CoC.[4]

Mr. Vallal RCK ("**Promoter**") placed a settlement plan ("**Settlement Plan**") before the CoC, seeking withdrawal of the insolvency proceedings under Section 12A of the Code. The Settlement Plan was initially approved by 70.63% of the CoC. Subsequently, one of the financial creditors decided to change its vote and approve the Settlement Plan and Withdrawal Application. Thereafter, in the next CoC meeting, the Settlement Plan and the Withdrawal Application was approved by more than 90% of the CoC.

Accordingly, the Resolution Professional ("**RP**") filed an application before the NCLT to withdraw the Section 7 application. The NCLT dismissed the Withdrawal Application stating that the Settlement Proposal was not a '*settlement simpliciter*'. Instead, the Settlement Proposal was a business restructuring plan, which was not permitted under the Code. The NCLT also ordered liquidation of the Corporate Debtor considering that the CIRP had failed and the Settlement Proposal suffered from legal infirmities.

Thereafter, the Promoter approached the National Company Law Appellate Tribunal, Chennai ("**NCLAT**") to challenge the order of the NCLT. However, the NCLAT refused to intervene and upheld the order of the NCLT. The Promoter preferred an appeal before the SC challenging the NCLAT Order.

JUDGMENT OF THE SC

Earlier, the SC and the NCLTs/NCLAT were allowing settlement between creditors and debtors on an *ad-hoc* basis. Therefore, the Insolvency Law Committee suggested introduction of an amendment to allow withdrawal of insolvency proceedings subject to approval of 90% of the CoC. The SC, while citing the legislative history, analyzed the object and intent of Section 12A of the Code and Regulation 30A of the CIRP Regulations to hold that approval of a settlement plan by the CoC is a product of the commercial wisdom which is paramount. Therefore, the NCLTs/NCLAT cannot intervene with such a decision of the CoC. Consequently, the SC allowed the appeal and quashed

the orders of NCLT and the NCLAT. Referring to an earlier judgment,[5] the SC stated that only if a CoC rejects a just settlement arbitrarily, then an NCLT can set aside such a decision of the CoC.[6]

ANALYSIS

It is trite that Section 29A bars a resolution plan by a certain class of persons which includes promoters of the corporate debtor. While promoters are ineligible to propose a resolution plan because of such a bar, Section 12A gives an option to promoters to regain control over the corporate debtor by proposing a one-time settlement plan. The basic intent of Section 12A is to permit a one-time settlement between the CoC and the debtor subject to an approval by 90% of the CoC.

Protracted Timeline of CIRP

The basic intent and purpose of the Code as set out in the preamble is to, *inter alia*, provide for insolvency resolution of a corporate debtor in a time bound manner which would lead to increased availability of credit for lenders.

In order to entertain and admit an application seeking initiation of insolvency proceedings, the NCLTs have to expend considerable time and resources. Once a CIRP has been instituted, public financial institutions and resolution professionals further expend time and resources.

Presently, promoters can retake control over the corporate debtor by way of a settlement proposal till the belated stage of initiation of the liquidation proceedings. If such a practice is allowed to persist, the promoters may resort to prolong the insolvency proceedings to the extent possible. This is likely to lead to substantial wastage of scarce infrastructure and resources. Therefore, allowing promoters to submit a settlement plan post invitation of expression of interest should be an exception and not the norm.

Resolution Plan v. Settlement Plan

The Code provides for certain mandatory contents of a resolution plan which ensures that interests of all stakeholders are safeguarded, *e.g.*, priority payment to operational creditors and dissenting financial creditors. However, a settlement plan by a promoter need not adhere to such checks and balances. Consequently, if the promoter defaults on the amounts owed to operational creditors, workmen, etc., it could lead to re-initiation of the insolvency process.

In the present case, the Settlement Proposal by the promoter set out a schedule for a deferred repayment of the creditors' dues. In case where the promoter failed to discharge their payment obligation under the Settlement Plan, it could lead to re-initiation of the insolvency process thereby leading to unnecessary wastage of time and resources of the stakeholders.

Reference:

[1] Section 12A of the Code states that an applicant may apply to the Adjudicating Authority to withdraw an application made under Section 7, 9 or 10 of the Code with the approval of 90% voting share of the CoC. The Regulation providing for a detailed procedure for such an application is Regulation 30A of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 ("**CIRP Regulations**").

[2] Regulation 36A

[3] Section 7(1): A financial creditor either by itself or jointly with other financial creditors, or any other person on behalf of the financial creditor, as may be notified by the Central Government may file an application for initiating corporate insolvency resolution process against a corporate debtor before the Adjudicating Authority when a default has occurred.

[4] The Resolution Plan was finalized by the Resolution Professional and put to a vote by the CoC, it received 60.19% votes in favour.

[5] *Swiss Ribbon Pvt. Ltd. v. Union of India*, *[2019] ibclaw.in 03 SC*.

[6] Paragraph 19 of the judgment.