Navigating Settlements and Withdrawals under IBC: Jurisprudence, Practical Challenges, and Strategic Considerations for Banks and Debtors

Introduction

The Indian Insolvency and Bankruptcy Code (IBC) was designed to provide a structured and time-bound mechanism for resolving corporate insolvencies. However, as more cases proceed through the National Company Law Tribunal (NCLT), banks and corporate debtors increasingly seek settlements before or during the Corporate Insolvency Resolution Process (CIRP). Settlements can offer faster recovery for creditors, while allowing debtors a chance to reorganize and avoid liquidation. Nevertheless, settlements bring legal challenges and operational complexities, particularly with requirements under Section 12A and collective action principles within the IBC.

The recent Supreme Court ruling in ***GLAS Trust Company LLC vs. Byju Raveendran and Ors***[1]. clarified the post-admission withdrawal process, emphasizing the structured framework under Section 12A and the limited use of Rule 11 powers. This article delves into the evolving jurisprudence on IBC settlements and withdrawal, key judgments, and practical suggestions for banks and debtors to approach settlements effectively while maintaining compliance with IBC mandates and collective creditor interests.

Background and Evolution of Jurisprudence

Initially, the Insolvency and Bankruptcy Code (IBC) did not include any provision for the withdrawal of proceedings after an application was filed. However, Rule 8 of the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016, allows the National Company Law Tribunal (NCLT) to permit withdrawal of an application before its admission, upon the applicant's request. Rule 8 states, 'The Adjudicating Authority may permit withdrawal of the application made under rules 4, 6, or 7, as the case may be, on a request made by the applicant before its admission.' Additionally, Rule 11 provides the NCLT with inherent powers to act in the interests of justice.

When withdrawal is sought after admission, however, the Tribunal has often relied on inherent powers or the concept of procedural closure to address such requests. In cases where the need for withdrawal warranted extraordinary intervention, the matter could be escalated to the Supreme Court, which, under Article 142 of the Constitution, has the authority to permit withdrawal of IBC applications in the interests of justice.

In the case of ***Mother Pride Dairy India Pvt. Ltd. v. Portrait Advertising & Marketing Pvt. Ltd***[2]. (2017), the National Company Law Appellate Tribunal (**NCLAT**), took the view that once an application is admitted, it cannot be withdrawn since other creditors are entitled to raise claims. An alternative course was worked out and it was held that, *"if the appellant satisfies the claim of other creditors, whoever has made claim, in that case Insolvency Resolution Professional will bring the matter to the notice of learned Adjudicating Authority for closure of the resolution process. The learned Adjudicating Authority in such case will consider the case in accordance with law, even before completion of Resolution process and may close the matter*."

Later-on in appeal[3], the Supreme Court also allowed the settlement under Article 142 of the Constitution, while observing that "*we find that the order passed by the National Company Law Appellate Tribunal is correct, yet we think it is a fit case to exercise power under Article 142 of the Constitution and accept the settlement that has been entered into between the parties. As we are accepting the settlement, the proceeding pending before the National Company Law Tribunal, stands disposed of.*" The Supreme Court further observed that in view of Rule 8 of the Insolvency and Bankruptcy (Application to

[1] Civil Appeal No. 9986 of 2024 with Special Leave Petition (C) No. 21023 of 2024- Decided on 23-Oct-24
[2] Company Appeal (AT) (Insolvency) No. 94 of 2017- Decided on 13.07.2017
[3] Civil Appeal No..9286 OF 2017- Decided on 28.07.2017

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Adjudicating Authority) Rules, 2016, the NCLAT could not utilise the inherent power recognised by Rule 11 of the NCLAT Rules, 2016 to allow a compromise before it by the parties after admission of the matter.

Tribunals have recognized the parties' right to settle and the importance of allowing withdrawal of the CIRP in such cases. In ***Lokhandwala Kataria Construction Private Limited v. Nisus Finance and Investment Managers LL***P[4], the NCLAT held that "before admission of an application under Section 7, it is open to the Financial Creditor to withdraw the application but once it is admitted, it cannot be withdrawn…Even the Financial Creditor cannot be allowed to withdraw the application once admitted, and matter cannot be closed till claim of all the creditors are satisfied by the corporate debtor." In this case too the Supreme Court[5] utilised the powers under Article 142 of the Constitution to allow settlement and withdrawal of IBC application.

Supreme Court of India in ***Amit Katyal v. Meera Ahuja***[6] case also permitted the parties to settle the matter and withdraw the CIRP proceedings by invoking article 142 of the Constitution of India. The Supreme Court expanded the concept with introduction of principle of larger interest of creditors and allowed withdrawal of IBC application where only 70% of the CoC members (being home buyers) were willing to withdraw IBC application. The Court observed that "*In view of the aforesaid facts and circumstances, more particularly when the withdrawal of the CIRP proceedings initiated by the original applicants is allowable by the NCLT in exercise of its powers under Rule 11 of the NCLT rules, 2016 and in the peculiar facts and circumstances of the case, instead of relegating the original applicants to approach the NCLT/Adjudicating Authority by moving an application under Section 12A of the IBC, we are of the opinion that this is a fit case to exercise powers under Article 142 of the Constitution of India as the settlement arrived at between the home buyers and the appellant and corporate debtor – company shall be in the larger interest of the home buyers and under the settlement and as undertaken by the appellant/corporate debtor, out of 128 home buyers, 82 home buyers are likely to get possession within a period of one year, for which they are waiting since last more than eight years after they have invested their hard earned money. This shall be in furtherance of the object and purpose of IBC*."

Section 12A is inserted by second amendment in IBC on recommendation by Insolvency Law Committee Report submitted in March 2018, to permit withdrawal of application on settlement even if CIRP has been initiated. Post this the Supreme Court in the case of ***Swiss Ribbons Private Limited and Another v. Union of India and others***[7], and in the case of ***Kamal K. Singh v. Dinesh Gupta & Another***[8] permitted withdrawal of CIRP proceedings in view of the settlement entered between the parties. In Swiss Ribbons case, it was also clarified that even after a petition under Section 7 of the IBC is admitted and before the Committee of Creditors is formed, the parties can settle the dispute. Further, even after the CoC is formed, Section 12A of the IBC does provide for a mechanism through which the petition can be withdrawn (if the parties were to reach a settlement).

In the case of ***Brilliant Alloys Pvt. Ltd. v. Mr. S. Rajagopal & Ors***., the Supreme Court expanded the jurisprudence on withdrawal of applications, allowing for such withdrawal even up to the stage of invitation for expression of interest. The Court observed that Regulation 30A(1) is directory, not mandatory, acknowledging that exceptional cases may permit withdrawal post-invitation for expression of interest under Regulation 36A. This decision emphasizes that once the Code is triggered by admission of a creditor's petition under Sections 7 to 9, **the proceeding becomes a collective process in rem, binding all stakeholders. Accordingly, given the proceeding's collective nature, it is essential that the Committee of Creditors (CoC), the body responsible for overseeing the resolution process, be consulted before permitting any individual corporate debtor to settle its claim independently**.

In Vallal RCK Vs. M/s Siva Industries and Holdings Ltd[9] the Supreme Court reinforced the principles established in Swiss Ribbons Pvt. Ltd. & Anr. v. Union of India & Ors., clarifying that if the Committee of Creditors (CoC) arbitrarily rejects a fair settlement or withdrawal proposal, the NCLT, and subsequently the NCLAT, can intervene to set aside such a decision under the IBC. The Court further emphasized the significance of the CoC's commercial wisdom, holding that when 90% or

[4] Company Appeal (AT) (Insolvency) No. 95 of 2017- Decided on 13.07.2017
[5] Civil Appeal No.. 9279 OF 2017- Decided on 24.07.2017
[6] Civil Appeal No. 3778 of 2020- Decided on 03.03.2022
[7] 4 SCC 17
[8] Civil Appeal No. 4993 of 2021, decided on 25.08.2021
[9] Civil Appeal No. 1811-1812 OF 2022; JUNE 03, 2022

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more of the creditors, after thorough deliberation, agree that a settlement and withdrawal of CIRP is in the best interest of all stakeholders, the adjudicating authority or appellate authority should not second-guess or override this decision.

In ***Ebix Singapore Pvt. Ltd. Vs. CoC of Educomp Solutions Ltd. & Anr***[10]. It was held by the Supreme Court that since the aim of the statute is to preserve the interests of the corporate debtor and the CoC, it was recognized that settlements between the corporate debtor and the CoC may be in the best interests of all stakeholders since insolvency is averted.

The NCLAT in ***Rajnish Gupta Vs. Union Bank of India & Other*** (2022) held that mere withdrawal of the CIRP against the Principal Borrower will not be a bar for the Respondent/Lender in initiating fresh CIRP against the Guarantor.

In Pratap Technocrats[11], the Supreme Cort emphasised on the judicial discipline in dealing with such matter by observing that: "***47. These decisions have laid down that the jurisdiction of the Adjudicating Authority and the Appellate Authority cannot extend into entering upon merits of a business decision made by a requisite majority of the CoC in its commercial wisdom. Nor is there a residual equity-based jurisdiction in the Adjudicating Authority or the Appellate Authority to interfere in this decision, so long as it is otherwise in 27 conformity with the provisions of the IBC and the Regulations under the enactment. […]***

50. Hence, once the requirements of the IBC have been fulfilled, the Adjudicating Authority and the Appellate Authority are duty bound to abide by the discipline of the statutory provisions. It needs no emphasis that neither the Adjudicating Authority nor the Appellate Authority have an uncharted jurisdiction in equity. The jurisdiction arises within and as a product of a statutory framework." (emphasis supplied).

In another case, the Supreme court while dealing with the issue, whether, in terms of the provisions of the IBC, the Adjudicating Authority can without applying its mind to the merits on the application under Section 7, simply dismiss it on the basis that the corporate debtor having initiated the process of settlement with the financial creditors, observed that "***The IBC is a complete code in itself. The Adjudicating Authority and the Appellate Authority are creatures of the statute. Their jurisdiction is statutorily conferred. The statute which confers jurisdiction also structures, channelises and circumscribes the ambit of such jurisdiction. Thus, while the Adjudicating Authority and Appellate Authority can encourage settlements, they cannot direct them by acting as courts of equity***[12]."(emphasis supplied).

It was further clarified by the Court that the "*threshold requirement of 10 per cent allotees of a housing project filing a petition under Section 7 of the IBC has been upheld by this Court in Manish Kumar v. Union of India*[13]*. However, in paragraph 181, this Court has held that such a requirement only needs to be assessed at the threshold while admitting the petition. Hence, if subsequent to the admission, withdrawal applications are preferred and the 10 per cent threshold is reduced, it shall not affect the maintainability of the original petition"*.

In ***E S Krishnamurthy case***[14] the NCLAT directed a Section 7 application to be disposed of, allowing the company three months to settle remaining claims, with an option for aggrieved petitioners to return to the Adjudicating Authority. The Supreme Court disapproved, clarifying that the Adjudicating Authority's role under Section 7(5) is strictly limited to either admitting or rejecting the application based on default, without compelling settlement. The Court emphasized that the IBC aims for timely resolution to maximize asset value, promote entrepreneurship, and maintain stakeholder balance. The Adjudicating Authority and Appellate Authority, bound by statutory jurisdiction, cannot act as courts of equity to enforce settlements outside the framework of the IBC. The Apex Court observed that:

"The Adjudicating Authority and the Appellate Authority are creatures of the statute. Their jurisdiction is statutorily conferred. The statute which confers jurisdiction also structures, channelises and circumscribes the ambit of such jurisdiction. Thus, while the Adjudicating Authority and Appellate Authority can encourage settlements, they cannot direct them by acting as courts of equity."

Thus, the Supreme Court and NCLAT have upheld the principle that while IBC is primarily a collective insolvency process, settlements that genuinely address creditors' interests and facilitate debt resolution should be encouraged. Pre-

[10] Civil Appeal No. 3224 of 2020- Decided on 13.09.2021
[11] Pratap Technocrats (P) Ltd. and Others v. Monitoring Committee of Reliance Infratel Limited and Another- 2021 SCC OnLine SC 569
[12] E S Krishnamurthy & Ors. Vs M/s Bharath Hi Tech Builders Pvt. Ltd.- Civil Appeal No 3325 of 2020
[13] (2021) 5 SCC 1
[14] Civil Appeal No 3325 of 2020- Decided on 14.12.2021

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admission settlements can proceed with ease, while post-admission withdrawals require 90% CoC approval under Section 12A to prevent disruptions to the insolvency process. The judiciary has also reinforced and highlighted that the commercial wisdom of the CoC is paramount, and that tribunals must avoid intervening in CoC decisions unless they are arbitrary or unjust.

The Judgement in GLAS Trust Company LLC vs. Byju Raveendran and Ors

The Supreme Court's judgment in the case of **GLAS Trust Company LLC vs. Byju Raveendran and Ors** is reiteration of the above legal position which emphasis on adhering to judicial discipline in dealing with such matters and observing the process and procedure set out under the Code.

Key Issues involved:

- ***Nature of Proceedings After Admission:***

The Court clarified that once an application under Sections 7, 9, or 10 of the IBC is admitted, the insolvency proceedings become proceedings in rem, meaning they involve not just the applicant and the corporate debtor but all creditors of the debtor. This transforms the proceeding into a collective action where the Committee of Creditors (CoC) plays a vital role.

- ***Withdrawal and Settlement of Claims:***
  - The Court examined how settlement and withdrawal of claims should be handled post-admission. The framework governing such withdrawals primarily comes under Section 12A of IBC, read along with Regulation 30A of the CIRP Regulations.
  - Withdrawal can only occur after the CoC is formed, with the approval of 90% of voting creditors. However, the process is elaborate, requiring input from all creditors, not just the applicant creditor.
- ***Framework for Withdrawal:***
  - The Court outlined that withdrawals could be made at four stages:
    - Before the Application is Admitted: Governed by Rule 8 of the NCLT Rules.
    - After Admission but Before CoC is Formed: Applications can be made through the Interim Resolution Professional (IRP) to the NCLT.
    - After CoC Formation but Before Expression of Interest: Requires approval of the CoC with 90% voting share.
    - After Invitation for Expression of Interest: The applicant must provide reasons for withdrawal, further scrutinized by the CoC and NCLT.
- ***Scope of Inherent Powers Under Rule 11:***
  - The judgment emphasized that Rule 11 of NCLT/NCLAT Rules provides inherent powers for settling disputes but should be invoked cautiously. In the IBC context, it should only be used where there is no explicit provision for handling the issue at hand.
  - The Court noted that after the introduction of Section 12A, inherent powers should not be used for withdrawal post-admission, as Section 12A and Regulation 30A provide a complete procedure.
- ***Earlier Legal Position:***

The Court referred to the Swiss Ribbons and Brilliant Alloys cases, which established the need for the CoC's involvement post-admission. It was made clear that once the CoC is constituted, the decision to allow or disallow withdrawal lies with the CoC, ensuring collective action by all creditors.

- ***Impact of Rule 11 Post-Amendments:***

The judgment further clarified that Rule 11 of the NCLT/NCLAT Rules cannot be invoked in cases of withdrawal after the constitution of CoC unless explicitly allowed under Section 12A.

The Supreme Court emphasized that post-admission withdrawal of claims is strictly governed by Section 12A and related CIRP Regulations, rendering reliance on Rule 11 misplaced in this context. It clarified that once an IBC application

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under Section 7 or 9 is admitted, the proceedings shift from a bilateral creditor-debtor dispute to a collective process impacting all creditors' rights and interests. Therefore, the NCLT must adjudicate settlement proposals with collective creditor interests in mind. The Court underscored that insolvency law is designed to protect all creditors' interests, not just specific parties, and that post-admission, the use of inherent powers under Rule 11 or Article 142 is limited to exceptional circumstances, as IBC provides an exhaustive settlement framework.

Jurisprudence on the Related Issues

- **Respect wisdom of CoC and allow withdrawal:** The Courts have emphasised on recognising the need to respect wisdom of CoC and allow withdrawal in the cases where settlement is reached. In this context it noteworthy that the Supreme Court in ***Abhishek Singh Vs. Huhtamaki PPL Ltd. & Anr***[15]***.*** *had laid down that once the parties had settled the dispute even before the CoC had been constituted, the application ought to have been allowed then and there rather than await the other creditors to jump into the fray and allow the IRP to proceed further. Section 12A did not specifically mention withdrawal of such applications where CoC had not been constituted but at the same time it does not debar entertaining applications for withdrawal even before constitution of CoC. Therefore, the application under section 12A for withdrawal cannot be said to be kept pending for constitution of CoC, even where such application was filed before constitution of CoC. The substituted Regulation 30A of IBC as it stands today clearly provided for withdrawal applications being entertained before constitution of CoC. It does not in any way conflicts or is in violation of section 12A of IBC. There is no inconsistency in the two provisions. It only furthers the cause introduced vide section 12A of IBC.*

- **Procedure in case of MSMEs:** NCLAT judgement in the matter of ***Saravana Global Holdings Ltd. & Anr. Vs. Bafna Pharmaceuticals Ltd. & Ors***[16] ***(later on appeal against this judgement was also rejected by the Supreme Court***[17]***)*** had added another dimension to the theory for MSMEs, by observing that the CoC need not strictly follow all CIRP procedures. If a settlement is reached before CoC formation or via Section 12A with a promoter's offer, steps like inviting external resolution applicants can be skipped. If the MSME's promoter offers a viable plan that satisfies creditors and maintains the debtor as a going concern, the CoC can approve it with 90% voting without issuing the Information Memorandum, thereby streamlining the process for MSMEs.

- **Promoter's right to Settle & Non Application of Section 29A:** NCLAT in the matter of ***Andhra Bank Vs.Sterling Biotech Ltd. (Through the Liquidator) & Ors***[18] held that from Section 12A and the decision of the Hon'ble Supreme Court in *'Landmark judgment of Apex Court in the matter of Swiss Ribbons Pvt. Ltd. & Anr. Vs. Union of India & Ors. under,* it is clear that the Promoters/Shareholders are entitled to settle the matter in terms of Section 12A and in such case, it is always open to an applicant to withdraw the application under Section 9 of the Code on the basis of which the CIRP was initiated and Section 29A is not applicable for entertaining/considering an application under Section 12A as the Applicants are not entitled to file application under Section 29A as 'resolution applicant'**.**

- **Will it change the character of debt if default Occurs posts settlement:** This issue was clarified by NCLAT[19], by observing that default in settlement agreement is only a by-product which has permitted revival of Section 7 application but in no manner affect the claim in the original application which is financial debt under Section 7 application. Vinay Gupta Vs. Ashika Credit Capital Ltd. & Anr. (2023)

- **In another case**[20]**, it was also clarified that the mere fact that instead of reviving company petition, a fresh company petition has been filed under section 7 shall not be reason to reject the company petition.**

Handling of Settlements in Insolvency Proceedings: Comparison with Major Jurisdictions

Settlements during insolvency proceedings are a critical aspect in all major jurisdictions, as they offer an opportunity for both creditors and debtors to resolve their disputes without continuing the full insolvency process. However, different jurisdictions handle settlements with varying degrees of judicial oversight, creditor protection, and regulatory frameworks. Here's an overview of how such situations are dealt with in Europe, UK, USA, and Singapore.

[15] Civil Appeal No(s). 2241 OF 2023 (Arising out of SLP (Civil) No.6452 of 2021)- Decided on 28.03.2023
[16] Company Appeal (AT) (Insolvency) No. 203 of 2019- Decided on 04.07.2019
[17] Civil Appeal No(S). 5344/2019- Decided on 15.07.2019
[18] Company Appeal (AT) (Insolvency) No. 601 of 2019- Decided on 28.08.2029
[19] Vinay Gupta v. Ashika Credit Capital Ltd.and Anr.- Company Appeal (AT) (Insolvency) No. 92 of 2023- Decided on 27-Jan-23
[20] Priyal Kantilal Patel Vs. IREP Credit Capital Pvt. Ltd. & Anr. (2023)- NCLAT

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- ***European Union (EU)***

In the EU, insolvency proceedings are primarily governed by the European Insolvency Regulation (Recast 2015). Each member state has its own domestic insolvency laws, but the EU regulation ensures that insolvency proceedings opened in one member state are recognized across the Union.

- **Pre-Insolvency Proceedings (Preventive Restructuring Frameworks):**
  - Under the EU Restructuring Directive (2019), member states are encouraged to offer pre-insolvency frameworks, allowing debtors to negotiate with creditors to restructure their debts before formal insolvency proceedings are initiated.
  - Preventive restructuring allows companies to avoid insolvency altogether by offering a settlement plan to creditors before formal proceedings start. These settlements are often supported by judicial oversight to ensure fairness to all creditors.
- **Post-Insolvency Proceedings:**
  - Once insolvency proceedings have commenced, creditors are often represented through a creditor committee similar to the CoC under the Indian IBC.
  - Settlements post-admission require approval from a certain percentage of creditors. For instance, in Germany, a settlement must be accepted by a majority of creditors in terms of both numbers and claims. Courts also play an active role in overseeing settlement proposals to ensure fairness and legality.

Judicial Oversight:

Courts have a significant role in monitoring and approving settlements to ensure they are in the interest of all creditors, especially if a significant portion of creditors oppose the settlement.

- ***United Kingdom (UK)***

In the UK, insolvency law is governed by the Insolvency Act 1986, and post-Brexit, the UK Corporate Insolvency and Governance Act 2020 introduced important reforms, including a new moratorium procedure.

- **Pre-Administration:**
  - The Company Voluntary Arrangement (CVA) is a common pre-insolvency mechanism allowing a company to propose a settlement plan to creditors. It is binding on all creditors if 75% of them, by value, agree to it.
  - Once the CVA is in place, it can prevent the company from entering full insolvency, provided the terms of the settlement are followed.
- **Post-Administration:**
  - Once insolvency proceedings are formally initiated through administration, any settlement requires approval from the administrator and creditors.
  - Administrators act similarly to insolvency professionals, assessing settlement proposals for the benefit of all creditors.
  - The UK Courts are involved to ensure the settlement does not unfairly prejudice a class of creditors, and they ensure procedural fairness, particularly if there are dissenting creditors.

Judicial Oversight:

The courts exercise a limited but crucial role in ensuring fairness and legality, especially when creditor approval is required. A court can intervene if there is evidence of coercion or undue influence in reaching a settlement.

- ***United States (USA)***

The USA follows a highly codified system under Chapter 11 of the Bankruptcy Code, which focuses on restructuring and rehabilitation of companies, as opposed to liquidation.

- **Pre-Bankruptcy Proceedings (Out-of-Court Settlements):**

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- Pre-bankruptcy settlements are common and encouraged under the Bankruptcy Code. These settlements often take the form of out-of-court workouts and can prevent the need for filing under Chapter 11.
- Creditors often prefer negotiated settlements before formal bankruptcy to avoid the lengthy and costly process of Chapter 11.

– **Post-Chapter 11 Filing:**

- After the filing, the Debtor in Possession (DIP) continues to run the company while negotiations with creditors take place. Any settlement requires approval from the Bankruptcy Court.
- Settlements post-filing are often presented as reorganization plans, which must be accepted by a majority of creditors and approved by the court.
- The court ensures that any reorganization plan or settlement complies with the absolute priority rule, which ensures that senior creditors are paid before junior creditors or equity holders.

Judicial Oversight:

The Bankruptcy Court plays an active role in approving settlements during Chapter 11 proceedings. The court ensures that the plan is in the best interest of creditors, complies with bankruptcy laws, and has been reached in good faith.

▪ ***Singapore***

Singapore's insolvency regime is governed by the Insolvency, Restructuring, and Dissolution Act 2018 (IRDA), which consolidated and modernized the insolvency laws in the country.

– **Pre-Insolvency Framework (Schemes of Arrangement):**

- Schemes of arrangement allow companies to negotiate with creditors before insolvency. Like the CVA in the UK, a scheme binds all creditors once a majority of 75% agree to it. The court must approve the scheme to ensure it is fair and equitable.
- The IRDA also introduced pre-pack schemes, where the court approves the scheme without a creditors' meeting if enough creditors agree to the scheme.

– **Post-Insolvency Proceedings:**

- After the commencement of insolvency, settlements can be negotiated, but they require the Official Assignee or Judicial Manager's involvement.
- The court plays a pivotal role in approving any settlement post-insolvency, ensuring that it does not disadvantage any class of creditors.

Judicial Oversight:

Courts are heavily involved in post-insolvency settlements, especially when it comes to ensuring that the settlement protects the rights of all creditors. The court ensures compliance with statutory provisions and fairness in the settlement process.

Navigating One-Time Settlements (OTS) Amidst Section 7 IBC Proceedings - Challenges and Considerations for Banks

Indian banks frequently encounter significant dilemmas when considering One-Time Settlement (OTS) offers with borrowers, especially during the pendency of Section 7 applications under IBC. Entering into settlements prior to or during insolvency proceedings poses multiple challenges, including potential preference claims by other creditors, the requirement for consensus among creditors, and complexities surrounding multi-creditor scenarios, particularly with operational creditors and home buyers.

▪ **Pre-Admission Settlements: Risks of Preferential Treatment**

When banks consider OTS offers before a Section 7 IBC application is admitted, they face the risk of the settlement being later viewed as a preferential transaction under Section 43 of the IBC, especially if such a settlement is executed solely with one creditor and to the detriment of others.

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- **Challenges:** Under IBC, any transaction that gives one creditor an undue preference may be scrutinized by the Resolution Professional (RP) if the company eventually enters the Corporate Insolvency Resolution Process (CIRP).
- **Consistency with Collective Mechanism:** The IBC is founded on a collective debt resolution mechanism. Thus, a single lender's settlement outside CIRP may contradict this collective intent and prompt other creditors to oppose the arrangement.
- The preferential transaction framework under Section 43 does not provide a straightforward exemption for settlements made before CIRP admission, leaving banks vulnerable to retrospective invalidation of the OTS.
- **Managing Preferential Transaction Risks in Pre-CIRP Settlements**
  - When dealing with multiple creditors, while it may be ideal to emphasis on need to settle with all the creditors, but a debtor may offer settlement terms to creditors individually if simultaneous agreements are impractical. In such scenarios, one or more creditors may find the terms favourable and choose to settle, while others may not yet reach an agreement. Settlements under these circumstances should not inherently be deemed preferential if they meet certain criteria that avoid giving undue advantage to any one creditor.
  - It is to be noted that Section 43 of the IBC does not explicitly exempt pre-CIRP settlements from potential challenges as preferential transactions, especially if they appear to disproportionately benefit a particular creditor. However, it is important to clarify that:
    - For a transaction to be deemed preferential, it must provide one creditor with an advantage that is not available to others. Thus, if a settlement occurs in the ordinary course of business without any additional benefits such as new collateral, or converting unsecured debt into secured debt, it may not fall under the ambit of a preferential transaction. The intent here is to allow financial flexibility that can help prevent insolvency while not disadvantaging other creditors.
    - Settlements facilitating debt discharge can actively contribute to the revival of the debtor's business by reducing overall liabilities. As long as the settlement aligns with this objective and does not harm other creditors' recovery potential, it can support financial rehabilitation in a fair manner.

Therefore, Banks may actively encourage settlement with the debtor within the framework of RBI Guidelines and their own policies as this furthers the objective of the Code and also helps in facilitating faster realisation of their dues.

- **Post-Admission: Consensus Among Creditors and Approval Process**

Once the CIRP is initiated, the dynamics shift as any withdrawal of the application or settlement would require approval from 90% of the Committee of Creditors (CoC) by voting share under Section 12A and Regulation 30A of the CIRP Regulations. Achieving this threshold can be highly challenging, particularly when numerous creditors or complex interests are involved.

- **Challenges:**
  - **Achieving 90% Approval**: Securing consensus from a vast majority of creditors can be challenging, especially when operational creditors or home buyers are involved. Differing interests and priorities can create significant obstacles to the collective acceptance of an OTS.
  - **Involvement of Operational Creditors and Home Buyers**: Home buyer-related insolvency cases, such as those highlighted in Manish Kumar v. Union of India, underscore the complexities of accommodating various stakeholders with varying motivations and financial commitments. Banks must navigate these diverse interests carefully, as the settlement may be less attractive to these creditors than a full CIRP.
  - **Absence of NCLT's Power to Enforce Terms**: Upon granting withdrawal under Section 12A, the NCLT does not supervise the terms and conditions of settlement. Therefore, enforcing compliance with settlement terms, especially long-term payment plans, can become challenging, leading to a potential default and re-initiation of CIRP.
- **Suggestions:**
  - **Structured Settlements with Timelines:** Banks can consider incorporating structured timelines and milestones within the settlement agreement. This provides a mechanism to revive CIRP proceedings promptly should the borrower default on OTS payments.

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- **Creditor Engagement and Consensus Building:** Engaging all creditors early on and providing transparency on the OTS terms could foster support. Additionally, banks can consider formalizing sub-agreements with critical stakeholders, aligning their interests with the bank's position.

- **Conditions and Terms for Effective Settlements**

Given the strict thresholds for creditor approvals and procedural requirements under Section 12A, banks must carefully consider the settlement structure to ensure that it is both enforceable and appealing to other creditors.

- **Key Conditions:**

  - **Immediate Payment or Short Payment Windows:** Typically, banks provide a three-month payment window under OTS agreements. However, during CIRP, creditors may hesitate to withdraw the application without upfront payment or guaranteed collateral. Therefore, there is need to balance the concern and payment of a reasonable amount say 25-30% (depending upon the amount of settlement) of the settlement amount may be stipulated to be deposited in a no-lien account before the application is filed for withdrawal of the IBC application based on the consensus reached among the creditors.
  - **Revival Provisions:** Banks should build-in revival clauses, enabling them to reinstitute CIRP if the borrower defaults on OTS payments. This ensures that CIRP remains a viable recourse and maintains pressure on the borrower to comply with settlement terms.

Operational Terms for Settlement Agreements in IBC Context Post-CoC Formation or otherwise

Focus should be on crafting settlement agreements with robust operational and procedural terms that consider multi-party coordination, payment schedules, security arrangements, and legal proceedings. Following points need to be considered in such a situation:

- ***Preservation of Existing Security Arrangements:***
  - All existing securities and guarantees should remain in place until full payment of the settlement amount.
  - In situations involving a new investor, securities and guarantees should still be retained, particularly if the promoter group is not fully exiting. Only in cases where the existing promoter group is entirely replaced may releases be considered, with CoC approval.
- ***Payment Tenure and Timeline Flexibility:***
  - The settlement agreement should outline a clear payment timeline (including payment of interest and other charges) to ensure accountability from the debtor, with a clear default clause for revival of the CIRP and IBC proceedings and preserving other legal remedies in the event of default.
  - Banks may retain the option to extend timelines if payments are on track but require flexibility, although such extensions (including charging of interest) should be documented and agreed upon by all stakeholders.
- ***Handling of Legal Proceedings:***
  - Existing legal proceedings, including suits and recovery actions, should be kept in abeyance until the settlement's final payment.
  - In cases where a consent decree is feasible, a court order can be obtained to document the terms of the settlement, providing an additional layer of enforceability.
  - The debtor should withdraw any litigation and counterclaims filed against the banks as part of the settlement terms.
- ***Criminal Proceedings:***
  - Banks must adhere to the RBI's restriction on withdrawing criminal proceedings in an OTS.
  - Banks cannot provide a commitment to withdraw these cases, although they can note that the debtor may seek redress from the appropriate court for closure. Courts often support the dismissal of minor cases when parties reach a settlement.
- ***Clarity on Non-Preferential Treatment:***

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- To protect against claims that the agreement provides unfair preference, the settlement document should clearly state that the terms are part of a collective effort for financial rehabilitation and do not constitute preferential treatment under the IBC.

Suggestions for Banks

The primary aim of initiating legal proceedings, including invoking the IBC, is to facilitate the recovery of dues. The IBC process is often preferred for its structured and expedited resolution mechanism, although actual recoveries have averaged around 35–40% of outstanding dues. To maximize returns and reduce prolonged legal costs, banks should actively encourage and support settlements, adopting an approach that streamlines and incentivizes fair, timely repayment plans wherever feasible. Bank may consider the following:

- ***Assessment of Net Present Value (NPV):***
  - Evaluate the NPV of expected cash flows from a settlement offer versus potential liquidation proceeds, factoring in delays, legal costs, and depreciation in asset value over time.
  - Consider the NPV of projected recovery, comparing it with realistic liquidation outcomes if the debtor is pushed into liquidation after prolonged litigation.
- ***Realistic Valuation of Security and Collateral:***
  - Rather than relying solely on book values, assess the actual realizable value of collateral, especially for depreciating assets or those facing encumbrances. Market conditions, the current state of the asset (e.g., factory equipment or land conditions), and local market demand should be taken into account.
- ***Factoring Enterprise and Market Value:***
  - Where applicable, consider the enterprise value as a going concern if there's potential for the business to recover. If the company has significant market presence or client base, it may provide better returns over liquidation.
  - Assess the impact of market conditions on the viability of asset sale prices, both in ongoing business operations and potential liquidation.
- ***Consideration of Debtor-Specific Challenges:***
  - Take into account challenges faced by the debtor, such as cash flow constraints, labor disputes, and ongoing litigation, which may impact the bank's recovery efforts if the matter proceeds to liquidation.
  - Review litigation costs, enforceability issues, or risks associated with the assets or property that could potentially reduce the realizable value over time.
- ***Conditions to Safeguard Settlement Compliance:***
  - Consider a phased or escrow-based payment plan, where the debtor is obligated to meet specific milestones before release of securities.
  - Ensure that the terms of settlement allow for a return to insolvency proceedings should the debtor default on settlement obligations.

Suggestions for Debtors

Settlements should not serve merely as a means to delay or evade IBC proceedings. Debtors must objectively assess their business viability and commercial standing, focusing on realistic prospects for revival in a limited timeframe. For a settlement to be effective, debtors should be prepared to meet all commitments fully. In cases where resources are insufficient to restore financial health, debtors should remain open to options like divestiture or introducing new investors to ensure the company's revival and the satisfaction of creditor claims.

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- ***Transparency in Financial Disclosures:***
  - Present a comprehensive financial report detailing cash flows, enterprise value, assets, liabilities, and pending litigation. This transparency can help banks better assess the value of a settlement and alleviate doubts about the debtor's ability to honour commitments.
- ***Detailed Settlement Proposal with NPV and Market Rationale:***
  - Approach banks with a well-documented proposal that includes NPV calculations for the proposed settlement amount versus liquidation scenarios, addressing how the settlement may benefit the bank more than prolonged insolvency proceedings.
  - Clearly outline the challenges the business faces, such as asset conditions or operational constraints, and how these might affect recovery values if the settlement is delayed or the business is liquidated.
- ***Involvement of Other Creditors in Settlement Plans:***
  - Where feasible, involve other creditors early in the settlement plan to demonstrate collective support, especially if approaching a 90% consent threshold is anticipated.
  - Open discussions with operational creditors or other lenders can show a unified front, which may make it easier for the CoC to accept a settlement proposal.
- ***Structured Payment Plans with Guarantees or Phased Security Releases:***
  - Offer a structured payment plan that aligns with cash flows, demonstrating how each phase of payments will be met and what securities or collateral might be released at each milestone.
  - Consider offering security enhancements or third-party guarantees if possible, to strengthen the proposal without requiring immediate security release.
- ***Commitment to Withdrawing Litigation Against Creditors:***
  - As a show of good faith, the debtor should agree to withdraw any pending litigations or counterclaims against creditors, reducing legal friction and fostering a collaborative atmosphere.
  - When possible, the debtor can also propose to settle minor criminal or civil cases, facilitating smoother negotiations, although specific provisions about criminal cases should align with regulatory norms.

Additional Collaborative Recommendations

- **Neutral Valuations**: Banks and debtors may agree to hire an independent appraiser to provide an objective valuation of assets. This may reduce disputes over asset values and create a basis for fair settlement terms.
- **Regulatory Compliance and Approvals:** Both parties should ensure that the settlement terms align with regulatory guidelines and obtain necessary approvals to avoid future legal challenges.

These measures can help banks toward effective recovery through settlements, while debtors can demonstrate a realistic approach, making the settlement more attractive and feasible for all parties involved The complexities surrounding OTS settlements during pending or post-admission IBC proceedings highlight the balancing act that banks must perform. On the one hand, early settlement and resolution align with IBC's intent to prioritize resolution over liquidation.

Conclusion

The Supreme Court's stance in GLAS Trust Company LLC vs. Byju Raveendran and Ors. reaffirms the importance of collective resolution in IBC proceedings, mandating strict adherence to Section 12A and procedural protocols. For banks, this means balancing their recovery goals with the procedural rigor of IBC. Settlement proposals should be designed to ensure transparency, enforceability, and alignment with creditor interests. For debtors, entering into settlements demands a commitment to honour repayment terms and, where feasible, to involve all relevant creditors.

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We trust you will find this an interesting read. For any queries or comments on this update, please feel free to contact us at insights@elp-in.com or write to our authors:

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