

Section 12A and its significant impact on CIRP Process



R. S. Balasubramanyam

The author is an Insolvency Professional (IP) Member of IIIPI. He can be reached at rsbalasubramanyam7@gmail.com

The Section 12 A was inserted in the IBC in 2018 via an amendment by the Parliament. In the course of time, the provision of withdrawal under Section 12 A has become one of the flagship provisions under the IBC. As per the judgement of NCLAT in the matter of Sanjeev Mahajan vs. Nehru Place Hotels & Real Estates Pvt Ltd & Ors (2024), which was also upheld by the Supreme Court, the Section 12 application cannot be admitted once the CoC has approved the Resolution Plan, and it is pending for approval of the NCLT. Besides providing a detailed analysis on the operation of Section 12A from the perspective of jurisprudence developing around it, the article also explores various measures which can be used by creditors for mediation before filing insolvency petition.

Read on to know more....

1. Introduction of the IBC

The Insolvency and Bankruptcy Code, 2016 (IBC or the Code) was passed by Parliament on May 28, 2016, to ensure that the financially stressed companies which are either operating at lower scale or not in operation are brought back into operation and remain as going concern for the benefit of the various stakeholders in the eco system. The purpose as stated, inter alia in the IBC, is to consolidate and amend the laws relating to the reorganisation and insolvency resolution of corporate

persons, partnership firms and individuals, to maximise the value of assets and to increase the availability of credit. Further, the intention behind introducing IBC is also to ensure that the process should not be misused for recovery of the dues by the creditors and the liquidation of the Corporate Debtor (CD) shall be a last resort.

The IBC prescribes threshold debt limits for making an application, conditions, procedures, timelines,

adjudication, appeals for the resolution process of the CD. Besides covering CIRP and Liquidation, the Code also covers Pre-packaged Insolvency Resolution Process (PRIRP) for MSMEs, Fast Track Corporate Insolvency Resolution Process (FTCIRP) and Voluntary Liquidation of Corporate Persons (VLCP). The process typically involves the following steps:

- (i) The Financial Creditors under Section 7, (mainly debt lenders; and also includes the allottees of the real estate project); Operational Creditors (mainly supplier of goods and services) under Section 9 can approach the Adjudicating Authority (AA) to admit the company into CIRP if their dues of ₹1 crore and above are not paid by the CD.
- (ii) The CD under Section 10 of the IBC, can also approach the AA.

“ After the approval by CoC with 66% value of votes, RP submits the Resolution Plan to the NCLT for its final approval under Section 31. ”

- (iii) Once the CD is admitted into CIRP, there would be a moratorium under Section 14 inter alia in respect of any legal proceedings against the CD. Further, an Interim Resolution Professional (IRP)/ Resolution Professional (RP) is appointed who takes over the charge of the company, as an officer of the Court to run the company for the benefit of all the stakeholders. A Committee of Creditors (CoC) is formed under Section 21, which is the decision-making body. The RP issues invitation for Expression of Interest (EoI). Thereafter, the resolution plans are submitted by Prospective Resolution Applicants (PRAs) under Section 30 to the RP and then after the approval by CoC with 66% value of votes, RP submits it to the NCLT for its final approval under Section 31. The decision of the NCLT can be appealed before the NCLAT which can be challenged before the Supreme Court.

2. Genesis of Section 12A of the IBC

Section 12A was introduced into the IBC through an amendment by the Parliament w.e.f. June 6, 2018, to

provide an opportunity to promoters, suspended directors (SD) of the CD, which is admitted into CIRP, to regain/ take back the company that they had promoted, managed and have emotional connect. Thus, the purpose of Section 12A is to give promoters, an opportunity to come out of the CIRP.

In the case¹ of *Uttara Foods & Feeds (P.) Ltd. v. Mona Pharmachem*, the Supreme Court ruled that the competent authority may amend the rules to enable the NCLAT to exercise its inherent power under Rule 11 of the National Company Law Appellate Tribunal (NCLAT) Rules, 2016 to allow a compromise to take effect after admission of the insolvency petition. Thus, to allow withdrawal of such cases.

3. Section 12A

Section 12A of the IBC empowers the AA to allow the withdrawal of applications filed under Sections 7 or 9 or 10 of the IBC on an application made by the applicant with the approval of ninety per cent voting share of the CoC, in such manner as may be prescribed. The application can be withdrawn under Section 12A before or after the formation of the CoC and the provisions relating to withdrawal of the application is directory and not mandatory². Thus, the Code provides multiple opportunities to the SD to regain the CD.

- (a) The main precondition for withdrawal is that the 90 percent of the CoC members shall agree to it.

This provision of withdrawal is not applicable to Resolution Applicant³ under Sections 7, 9 and 10. In other words, the Resolution Applicants under the above Sections, once submit the Resolution Plan and the same is accepted by the CoC, then they cannot withdraw the Resolution Plan.

4. Section 29A of the IBC Code

Section 29A is one of the crucial sections under the IBC. This section determines who all cannot participate in the CIRP and submit Resolution Plan. Every applicant has to scrupulously follow the conditions of this Section.

¹ *Uttara Foods & Feeds (P.) Ltd. vs. Mona Pharmachem* [185/(2017) ibelaw.in 10 SC]

² *Swiss Ribbons Private Limited and Another vs. Union of India and Ors.* [(2019) 4 SCC 17]

³ *Maharashtra Seamless Ltd. vs. Padmanabh Venkatesh* [(2020) 158 SCL 567].

Section 29 A of the IBC prohibits the suspended directors and related parties from taking part in resolution process and submitting resolution plan for the CD.

The provisions of the Section 29A of IBC prohibit certain persons from taking part in the Resolution Process. Thus, one of the class of persons is, SD and their group and other persons connected with SD are precluded from submission of Resolution Plan. The premise behind barring the SD has been, *inter alia*, stated in the Report of the Insolvency Law Committee- March 2018 that it is due to the misconduct of the CD that default occurs, and it would be desirable to prevent them to regain the control and reward themselves at the expense of the creditors and it undermines the process of the IBC. However, Section 240A of the Code provides an exemption to the resolution applicants from Sections 29A (c) and 29A (h) if the CD is an MSME.

5. Impact of Section 12A on CIRP

Once the application under sections 7 or 9 or 10 of the IBC is admitted by the NCLT, the CIRP triggers. Under Section 12 of the IBC, the CIRP should be completed within 180 days and with approval of NCLT, the timelines can be extended to 270 and maximum 330 days.

Further, within 60 days of the Insolvency Commencement Date (ICD), the RP should issue Form G (Invitation for Expression of Interest) from those persons who are not barred under Section 29A of the IBC. Under Regulation 36B of IBBI (CIRP), Regulation 2016 and as amended from time to time, the RP shall issue RFRP including evaluation matrix and information memorandum within 5 days of the issue of "Final List".

Once the Final List is decided and RFRP is issued, the PRAs submit their plans along with EMD which is based on the assets of the CD under CIRP. The EMD does not carry any interest and is returned when the final decision is taken by the CoC. Substantial efforts and time are consumed in preparation of resolution plan which runs into hundreds of pages based on the assets of CD.

Even when the Successful Resolution Applicant (SRA) is decided by the CoC, the SD whose Section 12A

application was rejected by the NCLT would appeal before NCLAT and the Supreme Court. The disposal of these appeals would take considerable time due to pendency and for other administrative reasons.

Meanwhile, the SRA, who, based on the timeline as per his Resolution Plan, would have arranged funding, lined up professionals, other personnel will seek approval from various authorities as per the Resolution Plan. As at this stage, there is no certainty as to the ultimate outcome due to the pending application under Section 12A /appeal, the SRA would be forced to incur substantial cost till the final disposal of Section 12 A application.

In the case of *Sandeep Gupta vs. J.M. Financial ARC Ltd.*⁴, the CoC rejected the Section 12A application and proposed to consider the resolution plans received from the Prospective Resolution Applicant (PRA). However, the NCLAT New Delhi, *inter alia*, held that the PRA cannot direct the CoC to evaluate the Resolution Plan which was received by them and hence ordered to accept the Section 12A application. Thus, it is established that the PRA does not have right to get their Plan approved.

As per the Para 39 of the interim order, *inter alia*, it was stated that mere fact that the PRA has submitted resolution plan does not give him any right to get the plan approved, especially when CoC was interdicted from not considering the plan by interim order passed in these appeals. Thus, in the above case, despite the resolution plans along with the EMD were submitted and deposited, but the same was not opened in view of the pending decision of Section 12A application.

6. Opportunities/Reliefs available from the Banks and NCLT to the Promoters/Directors to retain their Company before the case is brought under IBC

(a) Relief measures from the Banks/ Financial Creditors (FC)

When the banks review the monthly/quarterly reports submitted by the CD as a part of the conditions of the loan/debt sanction, they generally discuss the matter with the promoters/SD from time to time, about the performance of

⁴ *Sandeep Gupta vs. J.M. Financial ARC Ltd., & Anr.*, in the case of Asian Hotels Private Limited [(2024) ibelaw.in 16 NCLAT]

the company, future growth plans, industry performance, impact of international environment, etc. If there is a delay on payment of interest /principal and when it is a NPA, the FC, intensely and frequently deliberate upon the business plan and its credibility as to how the company can overcome the financial stress and ensure repayment of the debts and interest which are outstanding and as well ensure the timely payment in the future.

Further, if the FC is of the opinion that the borrower is not a fraud/wilful defaulter and delay/default is mainly due to the unfavourable conditions prevailing in the industry like it happened in the case of power sectors, infrastructure, etc., or for various reasons such as war, covid, epidemics, they may resolve it by way of an additional loan, changes in repayment plans or conversion of loan into equity, etc. As per the Reserve Bank of India⁵ (RBI), even in the case of fraud/willful default account, the bank at its discretion can have “compromise settlement”. The penal measures currently applicable to borrowers classified as fraud or willful defaulter in terms of the Master Directions on Frauds dated July 1, 2016 and the Master Circular on Willful Defaulters dated July 1, 2015, respectively, remain unchanged and shall continue to be applicable in cases where the banks enter into compromise settlement with such borrowers.

Such penal measures entail inter alia that no additional facilities should be granted by any bank/ FC to borrowers listed as willful defaulters, and that such companies (including their entrepreneurs/ promoters) get debarred from institutional finance for floating new ventures for a period of five years from the date of removal of their name from the list of willful defaulters. In addition, borrowers classified as fraud are debarred from availing bank finance for a period of five years from the date of full payment of the defrauded amount. Thus, the above guidelines will ensure greater transparency of the whole process. Besides, the following measures can also be used for debt restructuring/ settlement before invoking the IBC:

- (i) Other stressed borrowers can avail the OTS (one-time settlement)/ re-structuring, with bank to

overcome the financial stress where the haircut for the bank varies from 35-50% of the loan and interest outstanding.

“ In the case of *SBI vs. Rajesh Agarwal*, the Supreme Court ruled that a borrower must be given a hearing by the lender before an account is classified as fraud. ”

- (ii) In the case of SBI⁶, the Supreme Court upheld a judgement of Telangana High Court that said a borrower must be given a hearing by the lender before an account is classified as fraud. In line to this judgement, the RBI has issued on July 15, 2024, Master Directions, 2024, providing for systematic process for issuing Show Cause Notices (SCNs) and for evaluating responses from individuals / entities under investigation before making any determination of fraudulent activity.
- (iii) Recently, the Supreme Court, in *Pro Knits case*⁷, though relating to MSMEs, *inter alia*, stated that the Framework for Revival and Rehabilitation of MSME vide Notification dated 29.05.2015, having statutory force, are binding to all Scheduled Commercial Banks (SCBs), licensed to operate in India by the RBI, as stated in the said Directions.

From the above, it is clear that the Banks/FI provides umpteen opportunities to the promoters/directors of the financially stressed entities to overcome from the stressed financial conditions. Typically, these negotiations consume 6 to 12 months.

(b). Relief from the NCLT/NCLAT

Furthermore, when the applications are filed under Sections 7 or 9 or 10 of the IBC for admission by the NCLT, the NCLT is considerate to provide an opportunity to the CD to settle the matter before its admission for CIRP and the case is adjourned typically for a period of 6 to 12 months.

⁵ *Sandeep Gupta vs. J.M. Financial ARC Ltd., & Anr.*, in the case of Asian Hotels Private Limited [(2024) ibclaw.in 16 NCLAT]

⁶ *State Bank of India & Others vs. Rajesh Agarwal & Ors.* [(2023) ibclaw.in 36 SC]

⁷ *Pro Knits vs. Board of Directors of the Canara Bank and Ors.* [(2024) ibclaw.in 177SC]

7. Important Case Laws-Section 12A

Despite reliefs are available to SD as mentioned above, they file Section 12A applications. Followings are the cases which are illustrative as to the litigation by the SD at all levels of judicial forum before /after formation of CoC and the time that is consumed in disposing of the case by the AA and NCLAT:

- (a) In the case of *Pratham Expofab Pvt. Ltd. vs. Anil Matta*⁹, the SD pleaded for considering his second application under Section 12A as the earlier application was rejected by the CoC while the Resolution Plan was accepted by CoC and pending for NCLT approval. NCLAT ordered to expedite the case in favour of SRA as nearly 4 years since the Resolution Plan was approved by CoC. It rejected the plea of SD.
- (b) In the case of *Asha Chopra and Ors. vs. Hind Motors India Limited*¹⁰, it was decided by the NCLAT, New Delhi, that an application under Section 12A is not permissible during the liquidation period in terms of the Section 33 and Regulation 2B of the Liquidation Regulation. Further, even during the Liquidation Process, the parties have arrived at a settlement, then the Application filed under Section 7, 9 and 10 can be withdrawn u/s 12A of the IBC.^{10a}

“ In *Sanjeev Mahajan vs. Nehru Place Hotels*, the NCLAT held that Section 12A application cannot be accepted once the Resolution Plan is approved by the CoC and pending before AA. ”

- (c) In the case of *Vallal RCK*^{10b}, the Supreme Court upheld the decision of CoC exercising their commercial wisdom as to acceptance of the settlement plan.

¹⁰ *Asha Chopra, Dimple Gulati, Deep Rathore vs. Hind Motors India Limited* through its liquidator Sh. K.V. Jain, and Ashish Mohan Gupta, Union Bank of India through its authorized representative Sh. Navneet Chauhan [2024 (10) TMI 463]

^{10a} *S. Rajendran, Liquidator of Arohi Infrastructure Pvt. Ltd. vs. Tata Capital Financial Services Pvt. Ltd.* – NCLT Chennai Bench IA(IBC)/514(CHE)/2022 in CP/672/IB/2017 dt 20th June 2022.

^{10b} *Vallal RCK vs. Siva Industries and Holdings Ltd. and Ors.* Civil Appeal Nos. 1811-1812 of 2022 Decided on 03-Jun-22.



- (d) If the Resolution Plan already approved by the CoC and pending before NCLT for approval: In the case of *Sanjeev Mahajan vs. Nehru Place Hotels & Real Estates Pvt Ltd & Ors*¹¹ it was inter alia, held by the NCLAT, New Delhi, that Section 12A application cannot be accepted once the Resolution Plan has been approved by the CoC and the application for approval of the Plan is pending before AA. Thus, NCLAT stated that the AA should have considered and decided the application for approval of the Resolution Plan rather admitting the Section 12A application. Further on an appeal by the SD, the SC held that it was not necessary for it to interfere with the judgement of NCLAT.

8. Conclusion

Clarifying the objectives of the IBC, the NCLAT in the matter of *Binani Industries Limited*¹² *Vs. Bank of Baroda & Anr.* (2018), said, “The first order objective of the Code is resolution. The second order objective is maximisation of value of assets of the firm and the third order objective is promoting entrepreneurship, availability of credit and balancing the interests of stakeholders. This order of objectives is sacrosanct.” This indicates that the time bound formal mediation mechanism with the promoters of CD should be tried prior to the initiation of CIRP. In this process, the banks, by using RBI’s “Master Directions, 2024”, judicial pronouncements and other instruments can work towards mediation.

¹¹ *Sanjeev Mahajan vs. Nehru Place Hotels and Real Estates Pvt Ltd & Ors* [2024 (2) TMI 680 – Supreme Court]

¹² Judgement dated 14th November, 2018 of the NCLAT in the matter of *Binani Industries Limited Vs. Bank of Baroda & Anr.*