

Effect of Breach of Settlement Agreement Under Insolvency & Bankruptcy Code

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The Insolvency and Bankruptcy Code, 2016 (“IBC”) being a relatively new legislation, has witnessed inconsistent interpretation of its various provisions, especially in respect of certain legal issues, which are grey areas i.e. the issues which are not specifically dealt with under the existing provisions of IBC. One of such interesting legal issue is effect of breach of settlement agreements, entered into between two parties, where one party promises to pay a certain amount to the other party. This article makes an attempt to deal with the impact of breach of a settlement agreement signed between two parties and applicability of IBC, in the following circumstances:

- (a) Breach of a Settlement Agreement entered during the pendency of IBC proceedings;
- (b) Maintainability of IBC proceedings against breach of a Settlement Agreement
- (c) Breach of a Settlement Agreement entered during the pendency of IBC proceedings**

The above issue assumed relevance on account of conflicting judgments passed by different National Company Law Tribunals (“NCLTs”) across the country on the issue, whether a petition initiating Corporate Insolvency Resolution Process (“CIRP”) against a Corporate Debtor, which is withdrawn under Section 12A of IBC, pursuant to a settlement agreement executed between the parties, can be revived, in the event of breach of provisions of such settlement agreement by the Corporate Debtor. Since, there were conflicting judgments, there was no uniformity and total confusion regarding the rights of the Creditors in the situation explained above and the following question arose for consideration:

“Whether, the CIRP shall revive automatically in case of breach of settlement agreement or whether the creditor shall be required to file a fresh application under the IBC?”

As mentioned above, there are conflicting judgments of different benches in the judgement of **Vaishno Industries Pvt. Ltd. vs. Horizon Global Ltd** the application seeking revival of the application and instead



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¹ MANU/NC/3122/2020

granted liberty to the Operational Creditor to file a fresh application, in the matter of **JFE Shoji Steel India Private Limited vs. Danke Technoelectro Pvt. Ltd.**², NCLT, Ahmedabad Bench, allowed the Operational Creditor to revive and restore the application in case of any default committed by the Corporate debtor in adhering the terms of the settlement agreement.

However, the above controversy has been settled in the recent judgment of **M/s. ICICI Bank Limited vs. M/s. OPTO Circuits (India) Limited**³, whereby the National Company Law Appellate Tribunal, Chennai Bench (“NCLAT”), has held that the CIRP can be revived in case of failure to abide by the terms of the settlement agreement executed between the parties.

FACTUAL BACKGROUND

In this case, the Appellant Bank (Financial Creditor) had extended some credit facilities to the Corporate Debtor, who defaulted and a debt to the tune of INR 1,07,85,59,340.96/- fell due against the Corporate Debtor. Pursuant to such default, the Appellant Bank initiated proceedings under Section 7 of IBC, before NCLT, Bengaluru. Consequently, the NCLT, Bengaluru admitted the application filed by the Appellant Bank vide order dated 18.03.2020 and initiated CIRP against the Corporate Debtor. The Corporate Debtor challenged the above order by filing a writ petition before High Court of Karnataka and the order admitting the above application was stayed by the High Court. During the pendency of the writ petition, on 22.04.2020, the Corporate Debtor approached the Appellant Bank with one time settlement (“OTS”) proposal, agreeing to pay a sum of INR 22.7 Crores as full and final settlement, which was accepted by the Appellant Bank vide OTS letter dated 10.07.2020.

Subsequently, an application under Section 12A of the IBC was filed by the Corporate Debtor before NCLT, Bengaluru, seeking termination of CIRP, in view of the settlement agreement signed between the parties. During the course of the hearing, the Appellant Bank filed a Memo, thereby, seeking liberty to revive/restore the order dated 18.03.2020, in the event of failure of the Corporate Debtor to adhere to the terms of settlement. However, the NCLT, Bengaluru, vide impugned order dated 17.08.2020, refused to allow the request made in the Memo and instead granted liberty to the Appellant to file a fresh application in accordance with the provisions of the IBC. Feeling aggrieved by such order, an appeal was preferred by the Appellant Bank before NCLAT.

FINDINGS OF NCLAT

The NCLAT while setting aside the order of NCLT, Bengaluru, observed the following:

- The NCLAT relied upon the decision passed by NCLAT, Delhi Bench in the matter of **Vivek Bansal v/s Bruda Druck India Pvt. Ltd.**⁴ which was in respect of proceedings initiated by an operational creditor under IBC and it was held that in the event of default by the Corporate Debtor and not adhering to the terms of ‘settlement agreement’ with respect to outstanding instalments, the ‘Operational Creditor’ shall be at liberty to seek revival/restoration of the CIRP.

² 2021 SCC OnLine NCLT 190

³ Company Appeal (AT) (CH) (Insolvency) No. 146 of 2021 decided on 28.04.2022

⁴ 2020 SCC OnLine NCLAT 582

- While relying upon the above judgment, it was held that NCLT, Bengaluru committed grave error by ignoring the precedent settled in the judgment of *Vivek Bansal (Supra)* and by refusing to give liberty to the Appellant to revive/resume the CIRP. It was specifically held that in case, the Corporate Debtor failed to adhere to comply with the terms of settlement in strict sense as agreed with the Appellant bank, the Bank would be free to revive the CIRP. It was also observed that the decision of NCLT, Bengaluru was erroneous, and against the principles of natural justice.

Though, the position with respect to Operational Creditors was settled some time ago in the matter of *Vivek Bansal (Supra)*, but in so far as Financial Creditors are concerned, this judgment settles a very important question of law.

(a) Maintainability of IBC proceedings against breach of a Settlement Agreement

The issue whether one can maintain proceedings under IBC for failure to comply with the terms of a settlement agreement, whereby, one party has agreed to pay some amount to another party, is another significant legal issue. In so far as this issue is concerned, once again, various benches of NCLT differ in their opinion. The NCLT, Hyderabad Bench, in the matter of ***SEW & Prasad, Joint Venture vs. Gati Infrastructure Private Limited***⁵, has admitted an application filed under section 9 of the IBC on the basis of a breach of settlement agreement executed between the parties, whereas, the NCLT, Allahabad Bench, in the matter of ***Delhi Control Devices (P) Limited vs. Fedders Electric and Engineering Ltd***⁶ held that “*unpaid instalment as per the settlement agreement cannot be treated as operational debt as per section 5(21) of IB Code. The failure or Breach of settlement agreement can't be a ground to trigger CIRP against Corporate Debtor under the provision of IBC 2016 and remedy may lie elsewhere not necessarily before the Adjudicating Authority*”. The above decision of Allahabad Bench has been relied upon and followed in many matters by different benches of NCLT⁷.

Finally, the above controversy was resolved by the judgement of NCLAT, Delhi, passed in the matter of ***Amrit Kumar Agrawal vs. Tempo Appliances Pvt. Ltd***⁸, wherein while discussing this issue, it was observed that a mere obligation to pay does not bring the liability within the ambit of ‘financial debt’ as defined under IBC. The debt, along with interest, if any, should be disbursed against the consideration for the time value of money. Mere breach of terms of any agreement including a Settlement Agreement by a party, whereby some payment was due, would not fall within the scope of Section 5(8) of IBC, so as to constitute a ‘Financial Debt’. Accordingly, it was observed that mere obligation to pay under a Settlement Agreement would

⁵ MANU/NC/1027/2021

⁶ 2019 SCC OnLine NCLT 8030

⁷ Omega Elevators vs. Prajay Properties Private Limited MANU/ND/2135/2021; Nitin Gupta vs. International Land Developers Private Limited MANU/NC/7563/2020; Nidhi Rekhan vs. Samyak Projects Private Limited MANU/ND/2721/2020; Gopal Chandra Agarwal vs. Gurukul Activity Centre Private Limited MANU/NC/1480/2022; Brand Realty Services Ltd vs. Sir John Bakeries India Pvt. Ltd vs. MANU/NC/7776/2020

⁸ 2020 SCC OnLine NCLT 1838

not amount to disbursal of amount for consideration against the time value of money, and thus, breach of such obligation would not entitle a party to invoke CIRP against the other party. It was also observed that dishonour of cheques handed over pursuant to the settlement agreement cannot be termed as a financial debt.

CONCLUSION

Considering the abovementioned judgements, the position with respect to settlement agreement entered into between the parties and effect of IBC on such settlement agreement has become crystal clear. It can be concluded, that in a case where, after the initiation of IBC proceedings, parties entered into a settlement agreement and there is a breach by the debtor, the creditor, whether a financial creditor or an operational creditor, has the liberty to revive the IBC proceedings. However, in a case, where a party wishes to avail the remedy under IBC for breach of the terms of a settlement agreement, an application under IBC shall not be maintainable.

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