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Admission of CIRP Under Section 7 of the IBC, 2016, is Liable to Be Recalled Upon Establishment of Fraud or Malicious Intent Under Section 65 of the Code

AUTHOR Tannya Baranwal, Zeenat Shabab

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The Hon'ble National Company Law Appellate Tribunal (NCLAT) in the matter of Acute Daily Media Pvt. Ltd. and Ors. Vs. Rockman Advertising and Marketing (India) Ltd. and Ors. bearing no. Company Appeal (AT) (Insolvency) No. 1480 of 2024 had upheld the order dated 12.06.2024 passed by the Adjudicating Authority (NCLT, New Delhi, Bench-II), terminating the Corporate Insolvency Resolution Process (CIRP) against a corporate debtor, having found that the insolvency proceedings were initiated fraudulently and with malicious intent. This decision reinforces the significance of the protective mechanism under Section 65 of the Insolvency and Bankruptcy Code, 2016, which prohibits the initiation of insolvency proceedings for a purpose other than the legitimate resolution of insolvency and is a safeguard against the abuse of the Code's process.

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Facts of the Case

"The Appellants had initiated CIRP under Section 7 of the IBC, claiming to be financial creditors based on loan agreements allegedly executed in 2016. An order admitting the application was passed on 17.05.2022. However, Respondent No.1(Rockman Advertising), a shareholder in the corporate debtor company, filed I.A. No. 3602/2022 under Section 65 of the Code,2016, asserting that the initiation of CIRP was fraudulent and intended to defeat ongoing litigation in Operational and Mismanagement Petition (OMP) proceedings related to illegal dilution of his shareholding from 62.57% to 17.86%.

The Adjudicating Authority vide its order dated 12.06.2024, allowed the application filed by the Respondent under Section 65 of the Code and terminated the CIRP, citing collusion, document fabrication, and strategic misuse of the insolvency process. The present appeal was filed challenging the said termination order.

Issues Involved

1. Whether in the facts of present case, there was sufficient evidence before the Adjudicating Authority to establish that the Section 7 application was filed collusively and with mala fide intent by the Appellants, thereby justifying the invocation of Section 65 of the IBC and the consequent recall of the initiation of CIRP against the Corporate Debtor?
2. Whether the Adjudicating Authority had jurisdiction under Section 65 to terminate CIRP proceedings post-admission on grounds of fraud and malicious intent?

Contentions of the Parties

By the Appellant: (Acute Daily Media Pvt. Ltd. and Ors.)

The Counsel for the Appellant argued that the existence of financial debt and default is well established. Loan disbursals made to the corporate debtor are supported by tally entries, and there has been no evidence of repayment by the corporate debtor. Furthermore, the total debt owed exceeds the threshold of ?1 crore, thereby fulfilling the criteria for maintainability of the application under Section 7 of the Insolvency and Bankruptcy Code (IBC), 2016.

It was further contended that minor technical deficiencies in documentation, such as incorrect or outdated addresses, or the use of standard-format loan agreements, do not negate the existence of a valid financial debt.

It was further argued that even if there were technical violations of the Companies Act in the manner the loan agreements were executed or approved, such infractions do not impact the maintainability of the application under the IBC.

By the Respondent: (Rockman Advertising and Marketing (India) Ltd. and Ors.)

The Counsel for the Respondent argued that the initiation of the Corporate Insolvency Resolution Process (CIRP) by the appellants constitutes an abuse of process under Section 65 of the Insolvency and Bankruptcy Code (IBC), which is a safeguard against fraudulent or malicious proceedings. It is argued that the application was a colourable device aimed at defeating Respondent No.1's legal rights, particularly in light of adverse findings against the appellants in the order dated 20.07.2022 in the OMP proceedings, which confirmed the illegal reduction of Respondent No.1's shareholding and ordered its restoration, thereby affirming his locus to invoke Section 65.

It was further argued that the alleged loan transactions forming the basis of the CIRP were fabricated, as revealed through forensic analysis which uncovered identical loan agreements across different creditors, premature references to the IBC prior to its enforcement, unstamped and undated documents, mismatches between board meeting dates and MCA filings, and address discrepancies. In addition, statutory audit reports from FY 2016–17 to FY 2020–21 recorded no borrowing costs or interest expenses in the corporate debtor's accounts, no evidence of loans in its books, and no interest income in Appellant No.1's balance sheets, thereby contradicting the claimed 12% interest. The Respondent's Counsel also highlights violations of the Companies Act, 2013, including contraventions of Section 76 due to unauthorized acceptance of loans from non-members and breaches of Section 186(2) as the loans exceeded Appellant No.1's paid-up capital without valid board authorization.

Findings of the Learned NATIONAL COMPANY LAW TRIBUNAL

The NCLT, in its findings, held that the initiation of CIRP by the Appellants was fraudulent and malicious and lacking bona fides, aimed at defeating the rights of Respondent No.1, the majority shareholder, thereby attracting the provisions of Section 65 of the IBC. It observed suppression and fabrication of material facts, including ante-dated loan agreements with inconsistent details such as incorrect registered office addresses, premature references to the IBC, identical formatting, and unverified board resolutions, none of which were supported by statutory audit reports that recorded no loans or borrowing costs. The Appellants were also found in violation of Section 186(2) of the Companies Act, 2013, having extended a Rs.50 lakh loan despite a paid-up capital of only Rs.10 lakh, and the CD had accepted deposits from non-members in contravention of Section 76. The timing of the Section 7 application, which coincided with adverse findings in related OMP proceedings, revealed an attempt to misuse the CIRP mechanism to frustrate parallel litigation. Furthermore, the absence of interest income in the Appellant's financials undermined the existence of a "financial debt" under Section 5(8) of the IBC. The NCLT also rejected reliance on the CD's internal Tally records as self-serving and instead preferred audited financial statements, which did not reflect any such loans. Asserting its jurisdiction under Section 65 even post-admission of CIRP, the NCLT allowed I.A. No. 3602/2022, thereby terminating the CIRP, and directed issuance of a show cause notice to the Appellants under Rule 59 of the NCLT Rules, 2016, for action under Section 65(1) of the IBC.

Findings of the Hon'ble NATIONAL COMPANY LAW APPELLATE TRIBUNAL

The NCLAT upheld the NCLT's findings, affirming that the CIRP was initiated fraudulently and with mala fide intent, and emphasized that the existence of debt and default does not shield a Section 7 application from scrutiny under Section 65 where collusion or abuse is proven. It held that the high standard of proof required under Section 65 beyond reasonable doubt was met through documentary inconsistencies, corporate law violations, manipulation of timing, and corroborative findings of fraud in parallel proceedings. The Appellant's arguments, including claims of minor errors, existence of debt, and irrelevance of Companies Act violations, were rejected as inadequate, and their explanation of templated agreements among family members was not accepted. The Tribunal clarified that setting aside the CIRP was not a review or recall of the admission order but a fresh substantive adjudication on fraud, which Section 65 of the Code permits. Consequently, the appeal was dismissed as meritless, no order as to costs was made, and the show cause notice for penalty under Section 65 was upheld.

Conclusion

This decision is a landmark affirmation of the judiciary's vigilance against the strategic abuse of IBC, 2016. It reiterates that while Section 7 of the IBC, 2016, enables creditors to initiate CIRP based on financial debt and default, this mechanism is not immune to scrutiny. Where the initiation is tainted by fraud or mala fide intent, Section 65 empowers the Adjudicating Authority to annul the proceedings to uphold the Code's integrity.

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