

Application for Avoidance Transactions Under IBC



*Section 46 of the IBC mandates the RP or Liquidator to look back for avoidance transaction of the Corporate Debtor for a period of one year from the Insolvency Commencement Date (ICD). This look back period is two years in case of related party transactions. However, no separate time period is provided for this activity and the RP/ Liquidator is required to conduct this activity during the CIRP. In the present article, the author traces the development of jurisprudence and various provisions related to the avoidance transactions under the IBC. He also highlights various difficulties related to avoidance transactions which leads to low recovery and makes suggestions for improvement including assigning this responsibility to any other professional and settlement among others. **Read on to know more...***



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1. Introduction

The Insolvency and Bankruptcy Code, 2016 (IBC) is brought in as a measure to revive companies which are defaulting in repayment of debts and accordingly failing. In the process of revival, maximization of value of assets of the Corporate Debtor (CD) is another objective sought to be achieved by the IBC. During the course of running the Corporate Insolvency Resolution Process (CIRP) of the CD, on forming an opinion by himself, the RP is duty bound to initiate a transaction audit/forensic audit of the books of accounts and records of the CD and draw conclusions on his own from such reports and accordingly file application for avoidance transactions to the Adjudicating Authority (AA). As stated under the CIRP Regulations of IBBI, forming an opinion on the matter of avoidable transactions in the case of the CD is individually done by the Resolution Professional (RP), but practically the RP may be getting or receiving various inputs from many stake holders during the CIRP of the CD. Subsequent to conductance of the transaction audit, filing of application to the AA for appropriate relief or reversal of avoidance transactions as part of the CIRP under the IBC and CIRP Regulations has been a daunting task for the RP.

This is always an additional task which the RP has to shoulder along with the primary task of running the CIRP, which involves engaging external professionals like forensic auditor, lawyers etc. and making his own studies and analysis of the transaction audit report/forensic audit report and the findings therein. The time limits within which the above procedure has to be done are referred under sub regulations of CIRP Regulation 35A which states the time limits at three levels:

- (i) An opinion has to be formed by the RP within 75 days from the Insolvency Commencement Date (ICD) as to whether there are transactions as referred under sections 43, 45, 50 or 66 have taken place in the case of the CD during the past period prior to the ICD.
- (ii) Further to forming an opinion as stated above, the RP may initiate a transaction audit/forensic audit of the books of accounts and records of the CD and subsequently determine within 115 days from the ICD about the presence of the transactions, as stated above, under sections 43, 45, 50 or 66.
- (iii) Once a determination is made about the occurrence of the said transactions based on the forensic audit report and RP's own evaluation and study of the matter, he shall apply to the AA for appropriate relief within 130 days¹ from the ICD. The RP is also duty bound to share a copy of the Application made to the AA with the Prospective Resolution Applicant (PRA) so that it can be considered and factored in by the PRA while submitting the Resolution Plan.

Forming an opinion as referred in the first sub-regulation of Regulation 35A is a subjective statement and there are no quantitative parameters prescribed for this. Determination by the RP that such transactions have actually taken place so that a reversal of such transactions is required can be based on Transaction Audit / Forensic Audit Report. Mere receipt of the said audit report cannot be the sole reason for the RP to determine such transactions, but it can be based on his independent evaluation of the said reports.

After determination of the transactions, a period of 15 days is available to the RP to submit application to the AA for reversal of such transactions. The author is of the opinion

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that for determining the existence of the said transactions, on receipt of the forensic audit report, the RP can also do further deliberations with the forensic auditor and legal consultations with lawyers as necessary. All these actions and documentations on the same can buttress the application for avoidance of transactions while it is being adjudicated by the AA. For doing all these actions no separate time period is available to the RP and it is within the period of CIRP. The time lines as referred under sub regulations of Regulation 35A are not available to the RP outside the CIRP period. As per the said regulations the time available to the RP for filing of avoidance application subsequent to determination of the occurrence of the transactions is only 15 days (130 days-115 days), which appears to be too short a period for doing such a voluminous task.

The filing of the application for avoidance transactions and its adjudication shall not affect the proceedings of the CIRP. This is very clearly envisaged under Section 26 of the IBC, meaning thereby the CIRP and application for avoidance transactions can be two separate processes and the latter can survive even after conclusion of the former. However, this cannot be generalised for all situations, but has to be viewed on a case to case basis. The decisions rendered in three recent judgements upheld the point that CIRP and application for avoidance transactions are separate and distinct processes. The first one is time bound whereas the time lines of the first one are not applicable to the second one. The three judgements stated above are:

1. *Tata Steel BSL Ltd Vs Venus Recruiters Ltd*² (2023)
2. *Aditya Kumar Tibrewal RP Vs Om Prakash Pandey*³ (2022)
3. *Jagdish Kumar Parulkar Vs Vinod Agarwal*⁴ (2023)

¹ Substituted by Notification No. IBBI/2022-23/GN/REG093, dated 16th September 2022 (w.e.f. 16-09-2022). Before substitution it was 135 days.

² ibclaw.in/09HC

³ ibclaw.in/278NCLAT

⁴ ibclaw.in/132NCLAT

2. Locus of the Applicant after Plan Approval

The judgement rendered by the Delhi High Court in *Tata Steel BSL Ltd Vs Venus Recruiters Ltd (2023)* is capable of settling down all the possible questions as to the running of the CIRP and proceedings of the application for avoidance transactions. The judgement confirmed that CIRP is objective in nature and time bound whereas the filing of application for avoidance transactions requires discovery of suspected transactions falling under sections 43, 45, 50 and 66 of IBC. Therefore, the adjudication of the application for avoidance transactions is to be distinct and separate from the resolution of the CD.

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Presently the IBC states that the resolution plans should provide for treatment of avoidance applications if these are pending at the time of submission of the Resolution Plan by the Resolution Applicant. This is referred under CIRP Regulations 38(2)(d). However, the application for avoidance transactions will not be infructuous due to the reason that it is filed subsequent to submission of the resolution plans and resolution plans could not account for such avoidance applications. There may be cogent reasons which delayed the filing of the avoidance application. If the avoidance applications filed, subsequent to the filing resolution plans with the AA, are interpreted as infructuous it will only unjustifiably enable the beneficiaries of suspected transactions to walk away scot-free. Most of the time money borrowed from creditors will be public money and private parties should not be permitted to unduly appropriate such money. In those case where the application for avoidance transactions is submitted by the RP but these are not accounted for by the Resolution Applicant in his approved Plan, the benefit from adjudication of such avoidance applications cannot be imparted to the Successful Resolution Applicant (SRA). Such benefit can be given to the creditors of the CD, as in many of the cases the creditors, who are often financial institutions, undergo a hair cut in settlement of their dues for the resolution of the CD. The judgement of the Delhi HC also stated that the RP will not be *functus officio*, for the purpose of adjudication of the avoidance

applications, in such of the cases where it is not accounted for in the resolution plans and is continued subsequent to the approval of the Resolution Plan. The remuneration of the RP for pursuing such applications can be decided by the AA.

3. Timelines for Application: Mandatory or Directory?

The conclusion in the judgement in *Aditya Kumar Tibrewal RP Vs Om Prakash Pandey (2022)*, reiterates that the time limits under CIRP regulation 35A are directive in nature. These time limits cannot be generalised for all the cases but will depend upon the facts and situations of each case. Avoidance applications cannot be simply rejected due to the reason that they are filed beyond the time limits of Regulation 35A. If there are existence of genuine reasons and situations by which the filing of the avoidance application is delayed and filed beyond the time limits, such applications can be entertained and admitted.

4. Look Back Period

Always a question confronted at the adjudication level of the avoidance applications is the look back period that can be covered by a Transaction Audit Report and accordingly in the Applications for avoidance transactions. This time limit is referred under Section 46 of the IBC which states that for avoiding an undervalued transaction the RP or Liquidator has to demonstrate that such transaction is made with a party within one year backwards from the ICD and if it is with a related party the above period of one year will be replaced by two years.

NCLAT-Chennai Bench, in the case of *Thomas George v. K. Easwara Pillai (2021)* upheld that restricting the number of years of look period for fraudulent transactions will be unjustifiable and unreasonably benefit the perpetrators under the shelter of restricted period.

Therefore, it is indirectly evident from Section 46 that the time limits referred therein are applicable only for transactions covered by sections 43 & 45 and these time limits are not applicable for transactions covered by sections 49 and 66, for such transactions the look back period can be any number of years. An avoidance application where in fraudulent transactions are involved cannot be rejected by the AA on the ground that the period covered is beyond the time limits mentioned under Section 46. Restricting the number of years of look period for

fraudulent transactions will be unjustifiable and will unreasonably enable the perpetrators of such transactions to find shelter under such restriction of the period. This point is upheld by the Hon'ble NCLAT, Chennai in the matter of *Thomas George v. K. Easwara Pillai and Others*⁵.

In the case of *Jagdish Kumar Parulkar Vs Vinod Agarwal (2023)*, NCLAT-Principal Bench reiterated that the time limits under CIRP regulation 35A are only directive in nature and no avoidance application can be dismissed on the sole ground of delay beyond the time specifications of the said regulation. If there are justifiable reasons and situations for filing the application beyond the time limits, such applications are maintainable. After evaluation and analysis of the Transaction Audit Report (TAR) the RP has to draw conclusions of his own and document it so that it can be demonstrated to the AA accordingly.

The above narrated three case laws converge to a settled position of law under IBC regarding the application for avoidance transactions as under:

- (a) The timelines mentioned under Regulation 35A are directory and not mandatory. Applications shall not be rejected merely on the ground of delay but should be viewed based on facts of each case,
- (b) Filing of application for avoidance transactions and adjudication of the same can survive CIRP which is also referred under Section 26 of the IBC.
- (c) The time limits of look back period mentioned under Section 46 are applicable only to transactions covered under sections 43 and 45. The look back period is not restricted in the case of transactions covered under sections 49 and 66 of the IBC.

As per various reports published, as of January 2023 claims of more than two lakh crores of rupees (₹ 2.3 trillion) filed as avoidance applications are pending at various NCLTs under the IBC in India but the pace of recovery of the same is very low and yet to pick up. Data shows that avoidance applications are filed in 809 cases, wherein a total value of transactions of ₹ 2.3 trillion is involved. Decisions have been rendered by the NCLTs only in 98 cases involving around ₹18100 crores while a dimly low amount of ₹64 crores recovery could be made.

If tasks related to avoidance transactions can be separated from the RP, and entrusted to another professional, the RP can effectively concentrate on bringing a resolution for the CD and accordingly revive it.

Efficiency and legal proficiency of the RPs who are pursuing the avoidance applications and speed at which these are disposed of by the adjudicating authorities are the primary reasons for faster or slower recovery from such applications. Prolonged litigations and appeals at the appellate forum or judicial authorities are the further reasons for the delayed and lower recovery. At times in the IBC eco system when the average CIRP period itself is more than 600 days, in place of the prescribed period of maximum 330 days, evaluation of the books of accounts and records of the CD, conducting a Transaction Audit, determination of the dubious transactions by the ex-management, framing and filing of avoidance applications are all invariably additional tasks and responsibilities cast upon the RP under the IBC. If these tasks can be separated from the RP, and entrusted to another professional, the RP can effectively concentrate on bringing a resolution for the CD and accordingly revive it. This can also facilitate early filing of applications and faster recovery of proceeds of avoidance applications. But all these require amendment of the concerned provisions of the IBC and the related regulations.

Something that is making the task of doing TAR and filing of application for avoidance transactions more difficult is that most of the companies coming under CIRP are not maintaining up-to-date books of accounts or books of accounts maintained by them are incomplete and cannot be relied upon. Even after filing an application under Section 19(2) of the IBC, for directions from the AA to the ex-management for cooperation to the RP, there are many cases where even after orders from AA, the ex-



⁵ *Company Appeal (At)(Ch) (Insolvency) No. 293 of 2021.*

management continues non-cooperation or doing delay tactics. The IP has to overcome all these factual realities and challenges to take the adjudication of the avoidance application to a logical conclusion. All these could be the reasons for the very low recovery rate of proceeds of the avoidance applications.

5. Possibility of a Settlement Mechanism

As explained in the previous paragraphs, getting the TAR done, filing applications of avoidance transactions and conductance of cases relating to these applications are always an additional daunting task on the IPs in the CIRP. So far it has proved to be costly, time consuming and leads to less recovery than what is applied for. Once avoidance application is admitted by the AA and under its consideration an option for settlement of the same by remitting a lump sum amount or other mechanisms, as accepted by the AA, can be thought of by the government and regulators. Fraudulent transactions for which criminal actions can be invoked can be kept out of the settlement mechanism. To this extent it needs introduction of new sections or chapter in the IBC. Enormous amount of time, cost and efforts could be saved if such an option is

available under the Code. A settlement mechanism under the IBC will considerably off load the cases of avoidance applications piled at various NCLTs and perennial litigation delays can be reduced. In some of the cases the RP is arrayed as a party in the further litigations on avoidance applications which happens subsequent to the approval of the resolution plans, or the CD is ordered for liquidation. A settlement mechanism can bring a solution to the litigation difficulties faced by the IPs post the resolution of the CD.

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Early recovery and realisation of amounts entangled in avoidance petitions and its adjudication can bring more funds into the public financial institutions and banks that are often secured financial creditors in the CIRP and funds advanced to the CD by these institutions are public money. Thus, amounts recovered early through any settlement or amnesty mechanisms will protect the public interest of our nation also.

