

Study Group Report: Avoidance Transactions under IBC 2016 – Improving Outcomes

1. BACKGROUND

- 1.1. The legal framework under IBC requires the IPs to establish/ demonstrate fair and transparent conduct of insolvency resolution process, casting upon an IP many responsibilities which are onerous at times. Such responsibilities, inter alia, include forming opinions, determining the amounts involved and filing application to Adjudicating Authority in respect of preferential, undervalued, extortionate and fraudulent transactions or PUFÉ/ Avoidance transactions.
- 1.2. Such exercise is intended to extract or disgorge the value from the erstwhile management or other wrongful beneficiaries in the direction of achieving value maximization for CD's business/assets. An IP can get transaction audit (contemporarily called as "forensic audit") of CD's books of accounts and other records from expert or can himself do the same, to establish and manage the requisite process.
- 1.3. The IBC 2016 is evolving and in the last few years many issues has got settled through rulings from various judicial authorities including from Hon'ble Supreme Court. However, in respect of Avoidance Transactions, though there has been a landmark ruling from Hon'ble Supreme Court, it seems that the litigations in this regard may be settled by various judicial authorities in near future.
- 1.4. It is however, also observed that in last over 5 years' period despite institution of around 700 PUFÉ applications filed in NCLT involving over Rs.2 lac crores worth of claims very few (about 100) have been adjudicated upon. The challenges include delays in admission, adjudication, and recovery proceedings. It is therefore imperative to analyze the contributing factors of such delays and accordingly ideate for improvement in dispensation/outcome.
- 1.5. With above backdrop, IIIPI constituted a study group to understand and analyze the underlying reasons contributing to delays or sub-optimal outcomes and to recommend ways to tackle such challenges. The scope of such study encompasses:
 - Identifying the sample size to gather data of avoidance transaction filings.
 - Gathering data/ suggestions from:
 - (i) IBBI/IIIPI (to the extent available)
 - (ii) IPs through google page survey
 - The above exercise is aimed at analyzing the extent and nature of underlying delays (pre-admission and post-admission), amounts involved. Post admission delays to be analyzed into reasons like lack of sufficient evidence, counter-litigation, others, etc.
 - Finalizing report on outcomes and recommendations/ suggestions basis such outcomes.
- 1.6. A Study Group was also constituted to work on the above, with necessary support from IIIPI with the following members:
 - CA Sarath Kumar
 - CA Kamal Garg, IP
 - CA & Adv. Nipun Singhvi, IP
- 1.7. In pursuance thereof and in concurrence with the Study Group, a survey was carried out in the form of a questionnaire being circulated to the IPs and amongst other things, the following two questions were specifically asked to be responded by the IPs taking part in the survey:
 - Challenges and Solutions (for improvement) in preparing (including collecting information) avoidance applications;

- Challenges and Solutions (for improvement) in concluding (including cooperation from stakeholders), post-filing of avoidance applications.

1.8. Comprehensive data points related to avoidance applications so far, were sought from various sources for analysis and drawing references for the purpose of the Study.

2. Outcome of Survey

2.1. The qualitative comments on challenges/ suggestions on the subject matter as collected from respondents in the survey have been summarized below:

2.1.1. Challenges Highlighted:

- Limited funds for appointing good auditors;
- Lack of available information. Challenges in getting quality data from CD/ third parties including physical access to underlying assets;
- Time constraint exert pressure on both IPs and Transactions Auditors, compromising effective analysis. Inadequate time allowed available, coupled with hostile environment;
- Challenges in getting COC approval/ ratification for appointing Forensic Auditors;
- Delays at NCLT to decide upon the fate, due to frequent adjournments and counter litigation;
- The legal provisions stipulate that in order to file an application, RP needs to have a clear ground to believe about existence of such transactions, which takes time;
- The manner of continuing the applications after the plan is approved – Committee of Creditors

(COC), Ex-RP and Resolution applicant (RA).

2.1.2. Solutions Suggested:

- A capacity may be strengthened by providing more Benches/ Members and Staffs;
- The Lenders (FCs) should be advised to share details/ information available with them including Certificate of Compliance in terms of RBI Circular No. RBI/2015-16/100 DBR.No.CID. BC.22/20.16.003/2015-16 dated 1st July 2015, para-No. 4.1. (i). reg. “Monitoring of End Use of Funds”;
- Law may provide for RPs to form prima-facie opinion on avoidance transactions rather than establishing it clearly
- Funding needs to be provided both for forensic auditor’s fees and competent counsel’s fees;
- Separate funds to be earmarked in the plan as well as liquidation estate for continuing the PUFÉ applications.
- Section 19(2) applications need to be disposed of quickly
- Assigning / Estimating value to PUFÉ transactions identified during CIRP in case of plan approval (as suggested by Hon’ble NCLAT in DHFL case).
- Appropriate direction to Central Government in case of fraudulent transactions (Section 213 of Companies Act, 2013 as directed in few cases by NCLAT) be amended in the law so that the RP and transaction auditors are not part of

trial in case same is to be filed with Special Courts;

- PUFЕ application should be proceeded ex-parte in case of nonappearance after 3 notices from AA so that the matters can be disposed in time bound manner;
- Proper documentary proofs and evidence need to be worked on by the IRP/ RP/ Liquidator (s), COC and auditors, to avoid delay and uncertainty;]
- Auditors to join in proceeding before AA for effective outcome.

3. STUDY GROUP'S RECOMMENDATIONS

3.1. Statistical Analysis: The data on avoidance transactions (till March 2022) has been received from various sources, which has been analysed and was discussed amongst the Study Group Members. The moot points are:

- Overall, since inception of IBC, 787 applications for avoidance transactions have been filed with the AA till March 31, 2022, involving dues of ₹2.21 lacs crores. Average amount per application works out to ₹280 crores.
- Of these applications, 73 applications involving dues of ₹0.15 lac crore only have been disposed with average amount per application at ₹207 crore. The balance (714) applications were ongoing as on March 31, 2022. Against this, recovery stands at ₹4,549 crore across 12 applications. However, the recovery is mainly attributed to only one application (viz. Jaypee Infratech Limited) showing recovery by way of recouping land parcels, valued at ₹4,500 crores.
- Average time taken in disposing application is 323 days, whereas ongoing applications have taken 793 days as on the cut-off date.

- Range (size-wise) of such applications as above have been analysed as well. It transpires that 71% of lower (size)-end applications (nos.) have an average application size (amount) of ₹21 crore, whereas remaining 29% of applications have an average size of ₹ 925 crore.

- Besides, division of such applications into various stages of CIRP and into nature (P/U/E/F/comboination thereof) has also been made. It is evident that majority (~70%) of applications (nos.) involve a combination of P/U/ E/F elements rather than singular element.

- Then analysis of above data basis the originating NCLT bench, has been made. As per the data, NCLT benches at New Delhi and Mumbai together have received 53% of total applications so far, having value of 63% of total claims under avoidance transactions. Other locations in the order of such parameter, are Kolkata (10% nos.) and Chandigarh (8%). Chennai (7%) comes next.

3.2. Quality of Forensic Reports: Besides what is deliberated in Para 2 earlier and Para 3.1 above, the study group members highlighted another major concern about the quality of the forensic audit reports.

3.2.1. The study group members were of the view that in many cases the forensic audit reports were rejected by the AA and accordingly the recovery as contemplated from the underlying PUFЕ transactions could not be materialized.

3.2.2. The RP/Liquidator should apply his mind and exercise his discretion while considering such audit report for forming opinion and determining the PUFЕ transactions, based on reasons to be recorded in writing while filing the application u/s 25(2)(j). For instance:


3.2.2.1. In *Jayesh Shanghrajka v. Divine Investments* M.A. No. 1893 of 2019 Hon'ble NCLT - Mumbai observed that:

“Further, even the auditor in its report has not categorized any transaction as fraudulent under section 66 of the Code. Not only this, but also the applicant has not even furnished the Forensic Audit Report for the perusal of this Bench which he should have done during filing of this application itself. He has blatantly mentioned that the forensic audit report gave him a reasonably strong hint of Vulnerable Transactions or other transactions that may be either regarded as breach of applicable law, or

deleterious of the interests of creditors or stakeholders, or otherwise, transactions not designed to be in good faith. This Bench, basing merely on hints cannot declare the said transactions to be fraudulent ones.”

3.2.2.2. In *Punjab National Bank v. Carnation Auto India (P.) Ltd.* IB NO. 302 (ND) of 2017 NCLT - New Delhi held that where liquidator filed application under section 66 on basis of a forensic audit report, application filed by liquidator was to be dismissed, as forensic audit report was weak and improperly conducted.

(to be continued....)



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- IBC & REGULATIONS: Introduction
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- Limitation Act & Other Securitization laws
- Companies Act 2013
- Corporate Finance & Constitutional Remedies

Online Study Material
Available

Last date to Register: One day prior to respective batch