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PUFE Transactions: From Erosion to Restoration

Guest of Honour at the 14th Batch of Executive Development Program (For IPs) on Mastering "Avoidance/ PUFE Forensics" Under IBC (Online) from 15th April to 17th April 2025.

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Dr. M. S. Sahoo is widely regarded as a leading authority on markets and regulatory frameworks in India. Over a distinguished career spanning decades, he has played several high-impact roles, including Distinguished Professor at the National Law University Delhi; Member of the Competition Commission of India; Secretary of the Institute of Company Secretaries of India; Whole-time Member of Securities and Exchange Board of India; and Economic Adviser to the National Stock Exchange of India. As a member of the Indian Economic Service, he served in key positions across multiple central ministries.

Dr. Sahoo spearheaded insolvency reforms. He was the founding Chairperson of IBBI, the first-of-its-kind regulator globally, and played a pivotal role in establishing the Insolvency and Valuation professions in India. His work contributed to India being recognised as the "most improved jurisdiction" by Global Restructuring Review in 2018 and to a significant rise in the World Bank's Ease of Doing Business ranking in resolving insolvency.

On 15th April 2025, Dr. Sahoo addressed the 14th Batch of the Executive Development Programme on Mastering "Avoidance/ PUFE Forensics" as Guest of Honour. In his address, he emphasised the crucial role of clawing back value dissipated through avoidance transactions in preserving the integrity of the insolvency process. Read on to explore his insights…

The Insolvency and Bankruptcy Code, 2016 (Code) identifies three types of avoidance transactions: (a) preferential transactions, (b) undervalued transactions, and (c) extortionate credit transactions. In addition, it recognises fraudulent transactions comprising fraudulent trading and wrongful trading. Together, avoidance and fraudulent transactions are referred to as PUFE (preferential, undervalued, extortionate, and fraudulent) transactions.

The PUFE transactions result in the unlawful loss to or transfer of value from the corporate debtor (CD). They must be set aside or avoided during an insolvency proceeding to restore the underlying value to the CD. Section 36(3)(f) of the Code treats the value underlying avoidance transactions as part of the liquidation estate. Given their potential value, which is recoverable only through legal proceedings, PUFE transactions are classified as 'not readily realisable assets' under Regulation 37A of the Liquidation Process Regulations, 2016. It is the duty of the resolution professional (RP) to identify such transactions and file applications before the Adjudicating Authority (AA) for value recovery.

As assets of the CD, PUFE transactions must be taken into possession by the RP, accounted for in the asset register, included in the information memorandum, considered in the resolution plan, and dealt with in a manner that maximises their realisable value. However, realisation entails litigation costs and delays, making PUFE transactions an asset-cum-liability. The Committee of Creditors (CoC), as the commercial decision-making authority, must determine how to handle these transactions during and after CIRP.

Commercial wisdom

In *Piramal Capital and Housing Finance Limited vs. 63 Moons Technologies Limited & Others* (Supreme Court, 1 April 2025), the Court reaffirmed the primacy of CoC's commercial wisdom in deciding whether and how

PUFE applications should be pursued and how potential recoveries are distributed.

In this matter, PUFE applications with an aggregate underlying value of ₹45,000 crore were filed. The approved resolution plan stipulated that the successful resolution applicant (RA) would pursue avoidance applications on a best-efforts basis; and recoveries (net of costs and expenses) from these would be distributed to financial creditors, either in proportion to their claims or in the manner decided by the CoC. As for fraudulent transactions under section 66, the plan ascribed a nominal value of ₹1, indicating no expected recovery. However, it provided that any positive recovery arising therefrom would accrue solely to the RA, who would also bear the full cost of pursuing such claims. On appeal, the NCLAT set aside the clause in the plan that permitted the RA to appropriate recoveries, if any, from fraudulent transactions.

On second appeal, the Supreme Court set aside NCLAT's order, observing that the RA's offer of ₹37,250 crore took into account the potential recoveries from pending section 66 applications. The resolution plan was the outcome of a commercial negotiation between the RA and the CoC after multiple rounds of deliberation. Thus, once such commercial wisdom is exercised in accordance with the law, it is not for the AA or NCLAT to sit in judgment over the merits of such decisions.

Different approaches

The Supreme Court noted that the Code classifies PUFE transactions into two distinct categories, each with its own distinct treatment and consequences. First, Avoidance Transactions (Sections 43–51): The CIRP must disregard these transactions to claw back the value lost during the look-back period, which is two years in respect of transactions with related parties and one year in other cases, notwithstanding the sanctity of the contract underlying the transactions. Second, Fraudulent Transactions: (i) Section 66(1): Contribution by persons who knowingly carried on business with fraudulent intent, and (ii) Section 66(2): Liability of directors during the twilight period (from when they knew or ought to have known CIRP was inevitable till the CD enters into CIRP) for failure to minimise creditor loss.

The law empowers the AA to order recovery of the value lost through *PUFE transactions*, based on an application of the RP. The manner of recovery is, however, different. For avoidance transactions, the recovery is asset-centric: the underlying property/value returns from the beneficiary to the CD, whoever has benefited must return it. However, in case of *fraudulent transactions,* the liability is personal: the individuals responsible for the misconduct must make good the loss even if they derived no personal gain.

Each type of PUFE transaction involves a different legal standard, factual inquiry, and remedy. The mechanisms of recovery and distribution of realised value also vary. Therefore, IPs must file separate applications for each type of transaction rather than bundling them together. The Supreme Court has explicitly advised against simultaneously alleging multiple PUFE characterisations in respect of a single transaction in a composite application.

Underutilisation of section 66(2)

The provision under section 66(2) of the Code has seen limited use, despite its potential to transform insolvency outcomes. When invoked effectively, it creates a powerful deterrent against delay in initiating CIRP. Directors who continue to operate a financially distressed company without initiating CIRP, when they knew or ought to have known that insolvency was unavoidable, can be held personally liable for the consequent losses to creditors. The prospect of personal liability incentivises early action, thereby accelerating admissions, enabling CIRP to commence closer to the onset of stress, and improving the prospects for resolution. This mechanism also aligns the interests of the CD and its management with the objectives of the Code. It encourages voluntary commencement of CIRP in the early stages of distress, when the chances of a successful rescue through a resolution plan are significantly higher.

There exists a notable temporal gap between the filing of an application for initiating CIRP and the actual commencement of the process. The Code mandates scrutiny of transactions occurring during the one-year or two-year look-back periods preceding the insolvency commencement date, depending on whether or not the counterparty is a related party. However, transactions executed in the period preceding the filing of the CIRP application often escape review, even though they may critically undermine the CD's solvency. Section 66(2) provides an elegant solution to this problem. If enforced diligently, it would result in timely admission within the statutory 14-day period. The fear of personal liability under this provision would prompt directors to file for CIRP, eliminating the delay between financial distress/ application for CIRP and the commencement of CIRP.

Section 66(2) is not merely a punitive provision but a strategic tool for improving insolvency outcomes. The onus is on RPs to ensure this provision is no longer overlooked but deployed wherever the facts warrant its invocation. When used diligently, it enables timely initiation, discourages value-destructive conduct, and aligns director conduct with creditor interests in the pre-insolvency phase. Systematic invocation of this provision can significantly enhance resolution outcomes and promote accountability in pre-CIRP governance.

Underutilisation of section 29A(g)

Section 29A(g) provides that a person shall not be eligible to submit a resolution plan, if such person, or any other person acting jointly or in concert with such person, has been a promoter or in the management or control of a CD in which an PUFE transaction has taken place and in respect of which an order has been made by the AA under this Code. This imposes ineligibility based on two cumulative conditions: (1) the person has been a promoter or part of the management or control of a CD involved in a PUFE transaction, and (2) the AA has issued an order to this effect under the Code.

Mere filing of a PUFE application is insufficient to trigger disqualification. The requirement of an AA order ensures procedural fairness and uniform application of disqualification across CIRPs. Since ineligibility under section 29A extends beyond the specific CIRP of the concerned CD to all CIRPs, a formal determination by the AA is necessary to give effect to such disqualification system-wide. If the prohibition were tied to an application filed by the RP in a specific CIRP, the person would remain eligible to participate in other CIRPs, undermining the purpose of Section 29A.

Vulnerability of RP

Section 26 makes it clear that the filing of an avoidance application does not affect the conduct of CIRP. This ensures that resolution efforts proceed uninterrupted. However, it also means that individuals accused of orchestrating PUFE transactions can continue to participate in the distressed asset market, both in the CIRP in question and others, until the AA rules on their case. This undermines section 29A and creates an incentive for accused parties to delay adjudication, whether through legitimate or dilatory tactics.

As of December 2024, 1,396 PUFE applications had been filed, with only 368 disposed of. Anecdotal evidence suggests that it takes about three years for these applications to be decided. During this time, individuals facing credible allegations of PUFE transactions can continue to operate unchecked, potentially acquiring other distressed assets and subverting the objectives of the Code.

This protracted pendency places RPs in a vulnerable position. In some cases, extant promoters, who are the only RA, are accused of PUFE transactions. The RP may have filed an avoidance application, but without a finding from the AA, cannot prevent them from submitting a resolution plan. If the RP admits the plan, they risk censure from the AA or disciplinary action from IBBI. If they reject it and the application is ultimately not upheld, the CD could be forced into liquidation for lack of alternatives. To prevent such untenable scenarios, the AA must dispose of PUFE applications in a time-bound manner, ideally, no later than the last date for submission of resolution plans in the CIRP.

Economic Significance

Reversing PUFE transactions materially advances the objectives of the Code in several ways:

Enhancing value realisation: Avoidance transactions claw back value unlawfully transferred out of the CD, thereby increasing the asset pool available to creditors. Greater realisations improve the feasibility of resolution plans and reduce creditor haircuts.

Preventing opportunistic behaviour: The disgorgement of ill-gotten gains sends a strong signal to the market that avoidance transactions will not be tolerated. This deters opportunistic conduct and ensures value remains within the CD, reducing the risk of financial stress in the first place.

Upholding stakeholder priority: PUFE transactions can distort the statutory priority waterfall, allowing certain stakeholders to jump the queue. Setting aside such transactions restores balance and protects the equitable treatment of creditors as envisaged under the Code.

Determining resolution outcomes: Data reveal a strong correlation between the extent of PUFE losses and the outcome of CIRP. The CDs that achieved resolution through approved plans had, on average, lost only about 5% of the admitted claims due to PUFE transactions. In contrast, those that ultimately faced liquidation had lost approximately 15% of the claims through such transactions. This suggests that CIRPs are more likely to culminate in liquidation where a greater proportion of value has been siphoned off through PUFE transactions. Further, CDs that were successfully resolved typically entered CIRP with assets valued at 17% of the admitted claims. Conversely, CDs that were liquidated had lost 15% of claims through PUFE transactions and were left with assets worth just 5% of the claims. Had these CDs not suffered such PUFE-related losses, they would have entered CIRP with asset values approximating 20% of the claims, comparable to those that were ultimately resolved. In such a scenario, they too could have been rescued through resolution plans.

Conclusion

PUFE transactions often determine whether a distressed CD is rescued or liquidated. The responsibility for identifying, evaluating, and pursuing these transactions lies squarely with the RP. Except in limited circumstances, no other party can initiate PUFE proceedings. The RP's actions in this regard, while subject to AA's satisfaction, are foundational to the Code's operation. This task must not be reduced to a compliance formality. RPs must not hide behind excuses of non-cooperation by the CD, auditors, or the CoC, nor should they cite lack of forensic support as justification for inaction.

RPs who successfully recover significant value through PUFE proceedings should be rewarded with market credibility. Conversely, those who neglect this critical function should be held to account, not only by IBBI and IPAs but by the market itself. To enable market discipline, the performance of RPs in dealing with PUFE transactions must be made transparent. IPAs should disclose the detection, filing, and success rates of PUFE applications for each IP. This will empower stakeholders, reinforce accountability, and elevate professional standards across the insolvency ecosystem.

While the performance of RPs is a necessary condition for realising value from PUFE transactions, it is not sufficient on its own. The greater responsibility lies with the AA, which must ensure the timely disposal of applications filed by RPs. Both RPs and the AA must strengthen their institutional capacity to effectively address the legal, factual, and procedural complexities inherent in PUFE transactions.