



# **AVOIDABLE TRANSACTIONS**

## **U/S 43, 45, 50 and 66 of IBC, 2016**

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# INTRODUCTION

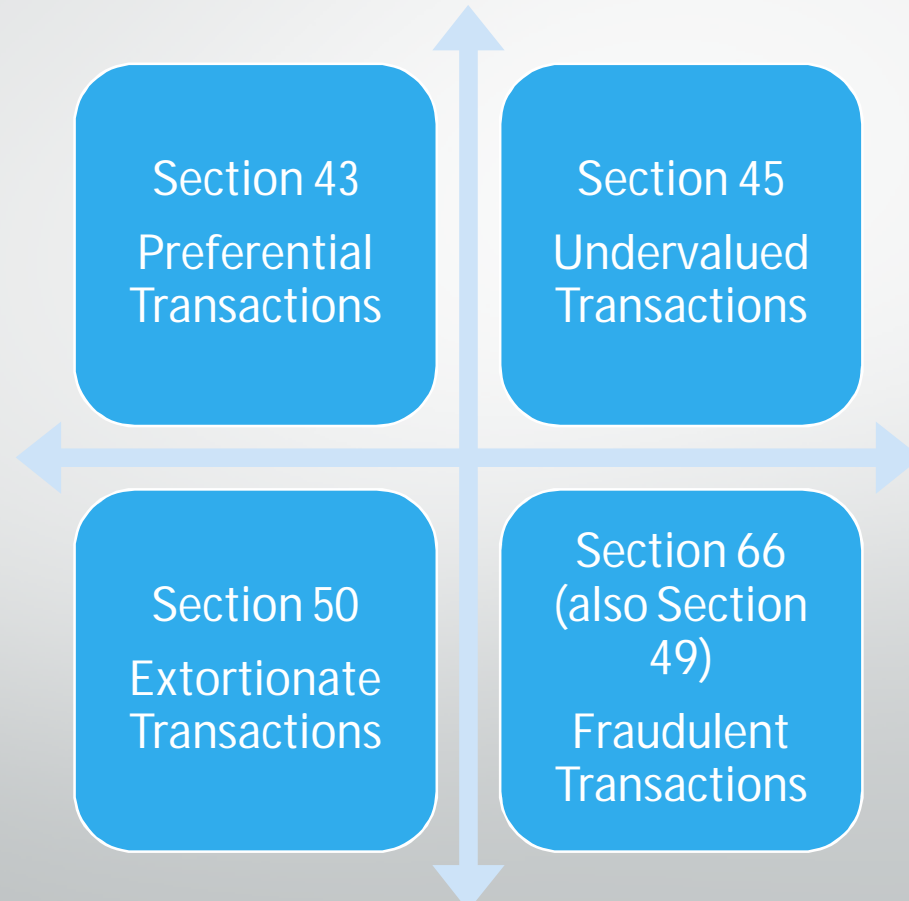
The Insolvency and Bankruptcy Code (“Code”) is a beneficial legislation aimed to put the corporate debtor back on its feet. It was enacted in 2016 by the Parliament of India to consolidate the law on reorganisation and insolvency resolution of corporate persons, partnership firm, individuals in a time bound manner. The objective of the Code is inter alia **protecting and maximization of the value of enterprise, innovation and managing interests of all stakeholders and promoting entrepreneurship** in a **time bound manner**. In this session we will discuss the legislative background and objective behind the inclusion of provisions pertaining to ‘Avoidance Transactions’- PUFEE under the Code.

The law pertaining to avoidance transactions is given under Chapter III and VI of Part II of the Code and it applies to both insolvency proceedings and liquidation proceedings.

# OBJECTIVE OF IDENTIFICATION OF THE AVOIDANCE TRANSACTIONS

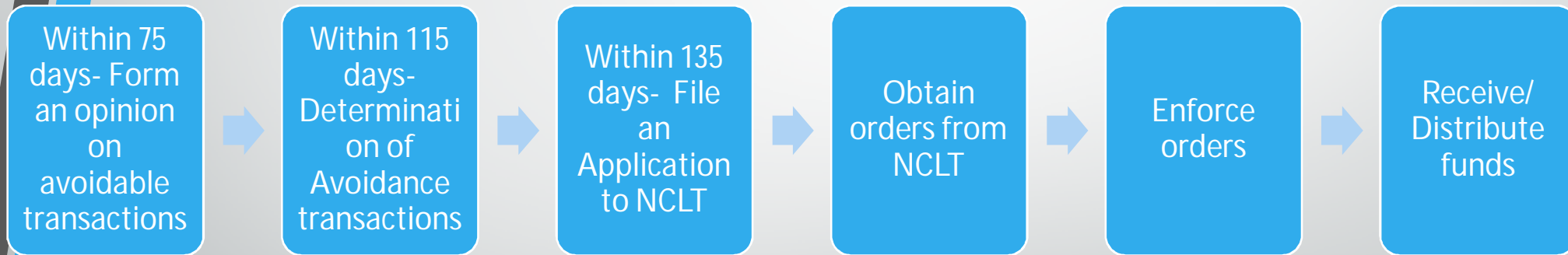
- To protect and maximize the value of the enterprise
- To reconstitute the integrity of the estate
- To ensure the equitable treatment of all creditors/stakeholders
- It is particularly important in the Indian context, where companies are often closely held by promoter groups who may seek to transfer value from/ to other group companies for their own benefit
- To ensure defaulters are brought to justice

# Overview of Avoidable transactions - P U F E




# ROLE OF RESOLUTION PROFESSIONAL/LIQUIDATOR

## TIMELINE



# ROLE OF RESOLUTION PROFESSIONAL/LIQUIDATOR

- As per Regulation 35A of Insolvency and Bankruptcy Board of India (Insolvency Process for Corporate Persons) Regulations, 2016, the following action shall be taken by the **RP** within the time lines mentioned below :
  1. Form an opinion whether the corporate debtor has been subjected to any transaction covered under sections 43, 45, 50 or 66- **Timeline:** On or before the seventy-fifth day of the insolvency commencement date
  2. Determine such transaction and intimate to IBBI- **Timeline:** on or before the one hundred and fifteenth day of the insolvency commencement date
  3. Make an application to Adjudicating Authority for appropriate relief - **Timeline:** on or before the one hundred and thirty-fifth day of the insolvency commencement date
- Section 35(1)(l) envisages the **Liquidator** to investigate the financial affairs of the corporate debtor to determine undervalued or preferential transactions
- Any asset or value recovered through proceedings for avoidable transactions to form part of Liquidation Estate u/s 36(3)(f)



**CATEGORISATION AND DETAILED  
UNDERSTANDING  
PUFE  
TRANSACTIONS**





**P U F E**

# **PREFERENTIAL TRANSACTIONS- SECTION 43**

# PREFERENTIAL TRANSACTIONS- SECTION 43

## Preference:

Preference is said to be given if –

- a) Transfer of property happens for the benefit of creditor / surety / guarantor; and
- a) Such transfer puts the creditor in beneficial position than what he would have been obtained, in the event of distribution of assets as per Section 53.

# PREFERENTIAL TRANSACTIONS- SECTION 43

## Exclusions of Preference:

The following are not considered to be in Preference:

- a) transfer made in the **ordinary course of the business** or financial affairs of the corporate debtor or the transferee;
- b) any transfer creating a security interest in property acquired by the corporate debtor to the extent that –
  - (i) such security interest **secures new value** and was given at the time of or after the signing of a security agreement that contains a description of such property as security interest, and was used by corporate debtor to acquire such property; and
  - (ii) such transfer was **registered with an information utility** on or before thirty days after the corporate debtor receives possession of such property: Provided that any transfer made in **pursuance of the order of a court** shall not, preclude such transfer to be deemed as giving of preference by the corporate debtor.

# PREFERENTIAL TRANSACTIONS- SECTION 43

## Look-back period

1. with related party – **2 years** preceding the insolvency commencement date (ICD)
1. with others – **1 year** preceding the insolvency commencement date (ICD)

# PREFERENTIAL TRANSACTIONS- SECTION 43

## Examples of common Preferential Transactions:

- Payment to unsecured family loans during the look back period, while the debt of secured creditors is outstanding
- Payment of old operational creditors (other than regular business payments against supply of goods or services), while the debt of secured creditors or unsecured financial creditors are outstanding
- Payment to an Unsecured Financial Creditor, maybe as per pre-fixed loan installments, while the debt of secured creditors is still outstanding

# PREFERENTIAL TRANSACTIONS- SECTION 43

## Examples of common Preferential Transactions:

- Creation of mortgage ('Security Interest') of the property for debt taken by Parent or Subsidiary Company, while the company itself is in stress.
- Payment to a secured creditor in priority while the debt of other secured Creditors is outstanding
- Adjustment of debit balances of debtors with credit balances of other parties would be considered as assignment of debt to operational creditors who have much lower priority u/s53
- Allotment of flats or plots by a real estate company to suppliers of goods or services in settlement of their outstanding



P U F E

# UNDERVALUED TRANSACTIONS- SECTION 45

# UNDERVALUED TRANSACTIONS- SECTION 45

**Transaction is considered to be undervalued where the CD:**

1. Makes a Gift to a person; or
2. Enters into a transaction which involves transfer of an asset for consideration which is significantly less than the consideration provided by the CD

Exclusion: Transaction taken place in ordinary course of business of CD.

The Adjudicating Authority may require an independent expert to assess the value of transaction (Sec 46(2))



# UNDERVALUED TRANSACTIONS- SECTION 45

## Look-back period

1. with related party – **2 years** preceding the insolvency commencement date (ICD)
2. with others – **1 year** preceding the insolvency commencement date (ICD)

# UNDERVALUED TRANSACTIONS- SECTION 45

## Examples of common Undervalued Transactions:

- Sale of office/ expensive cars or any other valuable property owned by the Corporate Debtor to related parties or unrelated parties at a value which is much less than the market value.
- Transfer of good franchisees to another person at a value which is much lower than the actual value
- Transfer of shares of subsidiary companies where the business is lucrative at a price which is less than the actual value
- Transfer of brand/trademark /copy rights owned by the Corporate Debtor without any existing value

# UNDERVALUED TRANSACTIONS- SECTION 45

## Examples of common Undervalued Transactions:

- Write off of sundry debtors or advances without justification or reasons or efforts to collect maybe considered as Gift
- Buying dead assets of the family or associate concerns to keep the assets or money of the Corporate Debtor away from the creditors –would be considered as Undervalued Transaction
- Sale of unsold inventory by real estate company at a price which is less than market price



P U F E

**EXTORTIONATE CREDIT TRANSACTIONS-  
SECTION 50**

# EXTORTIONATE CREDIT TRANSACTIONS- SECTION 50

It's a credit transaction involving the receipt of financial or operational debt.

Regulation 5 of CIRP Regulations –

A transaction shall be considered extortionate under section 50(2) where the terms:

- (1) require the corporate debtor to make **exorbitant payments** in respect of the credit provided; or
- (2) are unconscionable under **the principles of law relating to contracts.**

***Exemption:***

In compliance with any law for the time being in force

# EXTORTIONATE CREDIT TRANSACTIONS- SECTION 50

## Look-back period

-within two years preceding the date of commencement of insolvency

(Unlike Section 43 and 45 where there is a timeline of 1 year also)

# EXTORTIONATE CREDIT TRANSACTIONS- SECTION 50

## **The Adjudicating Authority may pass an order to:**

- Restore the position as it existed prior to such transaction;
- Set aside the whole or part of the debt created on account of the extortionate credit transaction;
- Modify the terms of the transaction;
- Require any person who is, or was, a party to the transaction to repay any amount received by such person; or
- Require any security interest that was created as part of the extortionate credit transaction to be relinquished in favour of the liquidator or the resolution professional.

# EXTORTIONATE CREDIT TRANSACTIONS- SECTION 50

## Examples of common Undervalued Transactions:

- Taking unsecured loans from parties at exorbitant interest rate and unfavorable conditions
- While the Corporate Debtor is under financial stress, the suppliers stipulating monopolistic terms to supply goods on credit
- Borrowing from employees, directors or associate concern at high interest Rates
- Purchases made from related parties/ director's or their relatives which are in ordinary course of business but not at arms length price. (purchases at a price higher than what purchased from others)

(Availing credit card loan at high interest rate is not an Extortionate Transaction)





P U F E

# FRAUDULENT TRANSACTIONS- SECTION 66

# FRAUDULENT TRANSACTIONS- SECTION 66

It is found that any business of the CD is carried on with intent to defraud creditors of the CD or for any fraudulent purpose

The Adjudicating Authority may by an order:

-direct that a director or partner of the CD, shall be liable to make such contribution to the assets of the CD, if-

- a) before the insolvency commencement date, such director or partner knew that there was no reasonable prospect of avoiding the commencement of a CIRP; and
- b) such director or partner did not exercise due diligence in minimising the potential loss to the creditors of the CD

# FRAUDULENT TRANSACTIONS- SECTION 66

## Look-back period

The Section 66 does not have any look back period

## TRANSACTIONS DEFRAUDING CREDITORS- SECTION 49

The transactions as defined u/s 45(2) i.e. undervalued transaction if deliberately entered by Corporate Debtor:-

- for keeping assets of the corporate debtor beyond the reach of creditors; or
- in order to adversely affect the interests of such creditors

The Adjudicating Authority shall make an order-

- restoring the position as it existed before such transaction as if the transaction had not been entered into; and
- protecting the interests of persons who are victims of such transactions

## TRANSACTIONS DEFRAUDING CREDITORS- SECTION 49

- The Section 49 does not have any look back period, as fraud operates as a nullity forever.
- Unlike other avoidable transactions, Section 49 requires intent on part of corporate debtor. In fact, it is the presence of intent that transforms an undervalued transaction into a fraudulent transaction for the above purposes.
- If a transaction comes under purview of section 49, it can trigger penal provision of Section 69. Section 69 provides for punishment of corporate debtor or its officers for entering into fraudulent transactions.

# FRAUDULENT TRANSACTIONS- SECTION 66

## Examples of common Fraudulent Transactions:

- Manipulation in the books of account or other records of the CD to deceive the creditors
- Purchase of properties and other assets in the name of the related parties/ directors and their relatives out of the funds of the corporate debtor
- Use of forged documents and records to obtain sanction and disbursement of credit facilities e.g. bogus exchange bills, sale bills for discounting, export and import bills for discounting for obtaining increased credit facilities from banks/FIs.
- Falsification of books of accounts by making entries of bogus expenditure for diversion of funds of the CD for personal gains by the management.
- Forging bank statements (personal withdrawal shown as payment to creditors)

# FRAUDULENT TRANSACTIONS- SECTION 66

## Examples of common Fraudulent Transactions:

- Siphoning of inventory/stock of the CD by showing increased consumption by falsification of books of account
- Trading through the shell entities
- Writing off debts/ receivables in the books of accounts by settling them in cash or in personal accounts.
- Fraudulent removal of property of the CD causing loss to creditors
- Giving loans or advances to related or unrelated parties without any business objective–would be **covered u/s49**
- Write off of sundry debtors or advances without justification or reasons or efforts to collect to defraud the creditors–would be **covered u/s49**

# DISTINCTION BETWEEN SECTION 45 AND 49

Both sections that are section 45 and section 49 pertains to the avoidance transactions.

The only difference between the two is that section 49 deals with undervalued transaction undertaken with a malafide or wrongful intention. Whereas for section 45 no such element is required.

The look back period is provided for section 45 but no such look back period for section 49 because once a fraud always a fraud .

The idea behind the provision is that any person who has done any act with malafide intention cannot get away by citing reason such as lapse of time .



# **DISTINCTION BETWEEN SECTION 43 V. SECTIONS 45, 49 AND 66**

The Court was of the opinion that there was a sharp distinction between the two sets of provisions with Section 43 on one side and Sections 45, 49 and 66 on the other.

The Court held Section 43 is a “deeming provision” and therefore, no intent was required in the violation of Section 43. All there has to be is a simple non-fulfilment of the requirements of Section 43.

On the other hand, Sections 45, 49 and 66 required an element of intent for their committal.

# AVOIDANCE TRANSACTIONS IN IBC AND COMPANIES ACT

Concept of Avoidance transactions existing earlier also.

The section 536 and 537 of companies act 1956 deals with avoidable transactions . Section 328 to 331 of **Companies Act 2013** deals with similar provisions. In Insolvency and Bankruptcy code 2016 , the similar provisions were incorporated.

The corporate debtor should avoid these transactions and the code has also imposed an obligation on the insolvency professional- RP/Liquidator to file an application for avoidance transactions.

# CASE LAWS AND KEY ASPECTS

- 1. Anuj Jain, Interim Resolution Professional for Jaypee Infratech Limited Vs Axis Bank [Civil Appeal Nos. 8512-8527 of 2019, 26th February, 2020, Supreme Court]**
- 2. Vital SA Abhishek Nagori (Liquidator) Vs. Asian Natural Resources (India) Limited [IA No. 212 of 2019 in IA No. 458 of 2018 in CP (IB) No. 19 of 2017 dated 29-May-20, NCLT Indore Bench]**

## **Anuj Jain, Interim Resolution Professional for Jaypee Infratech Limited Vs Axis Bank [Civil Appeal Nos. 8512-8527 of 2019, 26th February, 2020, Supreme Court]**

### **Brief Facts**

The appeal was preferred against the order of NCLAT by three sets of parties, namely, (i) Mr. Anuj Jain, the Interim Resolution Professional ("**IRP**") for corporate debtor Jaypee Infratech Ltd. ("**JIL**"), (ii) India Infrastructure Finance Co. Ltd., the financial creditor; and (iii) Homebuyers who have invested in the projects of JIL and Jaiprakash Associates Ltd. ("**JAL**"), the holding company of JIL.

The NCLAT set aside the order passed by NCLT, Allahabad Bench which had allowed the application filed by IRP appointed for JIL's corporate insolvency resolution process, seeking avoidance of mortgage transactions by JIL as being preferential, undervalued and fraudulent under **Sections 43, 45, 66** of the Insolvency and Bankruptcy Code, 2016 ("**Code**").

### **Issues**

- Whether the impugned transactions fall under the scope of preferential transactions under the Code?
- Whether the lenders of the holding company of a corporate debtor can be categorised as the financial creditors of corporate debtor?

## Anuj Jain, Interim Resolution Professional for Jaypee Infratech Limited Vs Axis Bank [Civil Appeal Nos. 8512-8527 of 2019, 26th February, 2020, Supreme Court]

### Decision

While deciding the first issue the Bench stated that the provisions of Section 43 of the Code and the following questions shall be examined to find whether a transaction falls within the ambit of Section 43:

- As to whether such transfer is for the benefit of a creditor or a surety or a guarantor?
- As to whether such transfer is for or on account of an antecedent financial debt or operational debt or other liabilities owed by the corporate debtor?
- As to whether such transfer has the effect of putting such creditor or surety or guarantor in a beneficial position than it would have been in the event of distribution of assets being made in accordance with Section 53?
- If such transfer had been for the benefit of a related party (other than an employee), as to whether the same was made during the period of two years preceding the insolvency commencement date; and if such transfer had been for the benefit of an unrelated party, as to whether the same was made during the period of one year preceding the insolvency commencement date?
- As to whether such transfer is not an excluded transaction in terms of **sub-section (3) of Section 43?**"

**Anuj Jain, Interim Resolution Professional for Jaypee Infratech Limited Vs Axis Bank [Civil Appeal Nos. 8512-8527 of 2019, 26th February, 2020, Supreme Court]**

It was held that the relevant time as per Section 43 of the Code is a period of two years preceding the insolvency commencement date, if the preference is given to a related party and a period of one year preceding the insolvency commencement date, if the preference is given to an unrelated party.

The Bench concluded the first issue by answering the above-mentioned questions and finding that “since the impugned transactions have the effect of putting JAL in a beneficial position than it would have been in the event of distribution of assets being made in accordance with Section 53 of the Code. Thus, the corporate debtor JIL has given a preference in the manner laid down in sub-section (2) of Section 43 of the Code.”

## **Anuj Jain, Interim Resolution Professional for Jaypee Infratech Limited Vs Axis Bank [Civil Appeal Nos. 8512-8527 of 2019, 26th February, 2020, Supreme Court]**

### **Duties and responsibilities of RP in CIRP as per section 25 w.r.t. Section 43**

- The combined application under section 43, 45 and 66 should not have filed as the degree of examination in preferential and undervalued & fraudulent are different.
- In preferential transaction, the intent is not involved by virtue of legal fiction of deeming provision, whereas for undervalued transaction requires a different enquiry under section 45 and 46 in which AA to require to examine the intent if such undervalued transactions was to defraud the creditors.
- Specific material facts are required to be pleaded if a transaction is sought to be brought under the mischief sought to be remedied by Sections 45/46/47 or Section 66.
- The AA would have examined the aspect of preferential, undervalued and fraudulent separately and distinctively

**Vital SA Abhishek Nagori (Liquidator) Vs. Asian Natural Resources (India) Limited [IA No. 212 of 2019 in IA No. 458 of 2018 in CP (IB) No. 19 of 2017 dated 29-May-20,NCLT Indore Bench)**

**Brief Facts**

The order of the Adjudicating Authority imply that the books of evidence for the past 10 years would have to be secured. Additionally, since this Adjudicating Authority did not curtail the scope of investigation to be carried out by the Resolution professional/ Interim Resolution professional/ Liquidator into Applicant's allegations, it was incumbent that custody of all books of evidence of the Corporate Debtor be taken to investigate into Applicant's allegations. However, it is discerning to note that the despite the passing of the order by this Adjudicating Authority as early as 6th November, 2017 there has been no action whatsoever either from the Interim Resolution Professional / Resolution Professional/ Liquidator of the Corporate Debtor.

The Applicant has also alleged that Liquidator is ill advised and misdirected by the belief that under the Code, **he is restrained from investigating any transaction undertaken prior to two years before the Insolvency Commencement Date**. It is stated by the Applicant that there is no specific look back period for transactions which have been with the sole intention of defrauding the creditors of a Company under Section 49 of the Code and therefore prays that this Adjudicating Authority be pleased to allow the Applicant to be impleaded as Respondent in I.A. No. 458 of 2018.




**Vital SA Abhishek Nagori (Liquidator) Vs. Asian Natural Resources (India) Limited [IA No. 212 of 2019 in IA No. 458 of 2018 in CP (IB) No. 19 of 2017 dated 29-May-20, NCLT Indore Bench]**

**Decision**

While a look-back period has been provided for undervalued transactions under section 46, **there is no limitation period for fraudulent transactions covered under sections 49 and 66 of the Code.** The intent is that **"once a fraud, always a fraud"**. The maxim **"fraud vitiates every transaction into which it enters as well as to contracts and other transactions"**.

The basic essence is that any person who has carried out any willful act should not be allowed to get away by citing reasons such as lapse of time or look back period is 2 years only. The prayer of the Applicant that the Applicant (Operational Creditor S.A. Vitol Arbitral Award Holder) be impleaded as a party to the proceedings in LA. No. 458 of 2018 is rejected.

Considering the documents, papers made available this Adjudicating has disposed of the IA No. 458 of 2018 filed by the Liquidator permitting him to scrutinize/investigate the transactions executed/entered by the Corporate Debtor beyond 2 years from the insolvency commencement date i.e. from 01.04.2008. However, the Applicant is at liberty to provide the relevant documents, information, to the Liquidator so that the Liquidation process is completed in time.



# THANKS

## Session is open for Questions

Presented by: CA Akash Shinghal

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