

**IN THE NATIONAL COMPANY LAW TRIBUNAL  
DIVISION BENCH – II, CHENNAI**

**MA/631/2018 in CP/665/IB/CB/2017**

*(filed under section 66 of Insolvency and Bankruptcy Code, 2016)*

***In the matter of M/s. SBQ Steels Limited***

**Mr. Ashish Rathi**

Resolution Professional for SBQ Steels Limited  
BDO Restructuring Advisory LLP  
The Ruby-Level 9, NW Wing,  
Senapati Bapat Marg,  
Dadar West, Mumbai-400028

*..... Applicant*

-Vs-

**1. Rajiv Rai**

No. 5, Ethiraj Lane,  
Egmore, Chennai-600105.

**2. Ritesh Rai**

No. 5, Ethiraj Lane,  
Egmore, Chennai-600105.

**3. Joseph Phillips**

6/13, North Avenue,  
Kesavaperumalpuram, Chennai – 600 028

**4. RKKR Holdings Private Limited'**

No. 6/13, Park Avenue  
Kesavapermal Puram Off Greenways Road,  
Chennai – 600 028

**5. Shantananda Steel Limited**

No.403-A, T.H. Road,  
Tiruvottiyur, Chennai – 600 019

**6. Rupal Rai**

9/5 Ethiraj Lane,  
Egmore, Chennai-600105.

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**7. Ritika Rai**  
9/5 Ethiraj Lane,  
Egmore, Chennai-600105

**8. RKKR Steels Limited**  
No. 6/13, Park Avenue  
Kesavapermal Puram Off Greenways Road,  
Chennai – 600 028

.....Respondents

Order Pronounced on 11<sup>th</sup> February 2022

CORAM :

**Justice (Retd.) S. RAMATHILAGAM, MEMBER (JUDICIAL)**  
**ANIL KUMAR B, MEMBER (TECHNICAL)**

*Counsel for Applicant* : *Srinath Sridevan, Advocate*  
*Bhagavath Krishnan, Advocate*

*Counsel for Respondents* : *Arun C Mohan, Advocate*  
*M.S. Shanmugasundaram,*  
*Senior Advocate*

## **ORDER**

**Per: Justice (Retd.) S. RAMATHILAGAM, MEMBER (JUDICIAL)**

MA/631/2018 is an Application filed by the RP in respect of the Corporate Debtor viz. SBQ Steels Limited under Section 66 of IBC, 2016, seeking relief as follows;

- (i) Declare that the impugned transactions entered into by the Corporate Debtor are fraudulent and wrongful transactions in terms of Section 66 of the Code;
- (ii) Direct Respondent Nos. 1 to 3 to make good of impartments amount to Rs.365.66 Crores (Rupees Three Hundred Sixty Five Crores and Sixty Six lakhs) caused on account of the transactions described in paragraphs 12 to

paragraphs 17, which were undertaken without necessary management approvals and independent assessment;

- (iii) Direct Respondent Nos. 1,2,3 and 4 to 8 being related parties and, to make good the losses amount to Rs.4.93 Crore (Rupees Four Crore and Ninety Three Lakh) incurred on account of questionable and fraudulent transactions / wrongful trading with the Corporate Debtor described in paragraphs 18 to paragraphs 21;
- (iv) Direct Respondent Nos. 1 to 3 to make good of Rs.24.82 Crore (Rupees Twenty Four Crore and Eighty Two Lakhs), being the amounts owned by them on account of unadjusted receivable balance in the respective accounts described in paragraph 22 and paragraph 23 due to lack of adequate documentation and rationale to support such transactions;
- (v) Any such other direction / instructions / order in terms of Section 66 and Section 67 of the Code, which the Hon'ble Tribunal may find fit in the facts and circumstances of the present case; and
- (vi) To award the costs of these proceedings;
- (vii) Any such other/ further order which the Hon'ble Tribunal may find fit in the facts and circumstances of the present case.

2. The Learned Counsel for the Applicant submitted that vide order dated 29.12.2017 CIRP in respect of the Corporate Debtor was initiated by this Tribunal and one Mr. Vasudevan was appointed as the IRP and thereafter, the Applicant herein was appointed as the Resolution Professional in respect of the Corporate Debtor by order of this Tribunal dated 03.04.2018. Subsequent thereto, it was submitted that the RP has appointed an Auditor to conduct a review

of business operations and activities carried out by the Corporate Debtor for the period from 29.12.2015 to 31.03.2018. It was submitted that the Auditor has accordingly reviewed the business operations and performance of the Corporate Debtor during the Review period.

3. It was submitted that the said Auditor has submitted a First Audit Report on 11.09.2018 and the Revised Audit Report on 05.11.2018 to the RP. As per the revised Audit Report, it was submitted that the Auditor has noted that high value assets and capital work in progress impairments were accounted in the FY 2015 – 2016 and FY 2016 – 2017 to an extent of Rs.365.66 Crore. On observing such high value, the Auditor requested the management of the Corporate Debtor to provide basis of assessment and necessary approvals, if any, for such impairments, however there was no reply.

4. It was further submitted that the Corporate Debtor was in default since 21.04.2014 and keeping the creditors interest in mind, prior to impairment of high value assets, the Corporate Debtor ought to have conducted an independent (third party) assessment of the rationale and value of impairment, however the same was not undertaken by the management of the Corporate Debtor and the same would point out the lack of due diligence on the part of the

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management of the Corporate Debtor. In response to the same, the management of the Corporate Debtor has stated that the accounting standard 28 does not warrant a third party evaluation of impairment.

5. It was further submitted that the Auditor has noted that the assets impaired were not insured and no physical verification of assets was conducted during the Review period by the Corporate Debtor. In response to the said observation, the management of the Corporate Debtor respondent that insurance premium was returned by the insurance premium without assigning any reason, however the management of the Corporate Debtor has not given any specific reason why it did not opt for another insurance provider to get its assets insured. Further, it was submitted that as observed by the Auditors in the Revised Audit Report the management of the Corporate Debtor has not provided any clarity, documentation, approval or assessment on how the impairment value was arrived at before writing off such high value assets. Therefore, it appears that the existence of such assets is in question and such a significant write-off on the high value assets of the Corporate Debtor is without adequate documentation and approvals.

6. It was submitted that the Auditor has identified the following transactions which are questionable in nature and the same appears to be fraudulent and wrongful in nature.



**a. RKKR HOLDINGS PRIVATE LIMITED – 4<sup>TH</sup> RESPONDENT**

6.1. It was submitted that the Auditor has noted that there was a vehicle (Honda Accord) sale at Rs.4 (Four) Lakh. Additionally no comparative quotations were obtained for such sale and the receivable balance was adjusted against the payable balance to this party resulting in no receipt of funds. It was submitted that the above mentioned transaction entered with the 4<sup>th</sup> Respondent being related party was placed at the meeting of the Board of Directors for necessary approval as per the provisions of Section 188 of the Companies Act, 2013. It was submitted that the auditor has furnished a third party evaluation, however it could not be relied since the valuation of the car was undertaken by a car vendor on as it basis and conditions was not assessed as on date of sale of the car.

**b. SHANTANANDA STEEL LIMITED – 5<sup>TH</sup> RESPONDENT**

6.2. It was submitted that between March 2016 to March 2017, multiple monthly payments were made, amounting to an amount of Rs.5.44 Crore towards the rent for an office premises i.e. Building Block I, situated at 6/13, North Avenue, Kesava Perumal, Chennai – 600 028 with built up area of 15,080 sq. ft.



6.3. It was submitted that as per the lease agreement dated 12.01.2014, the owners of the building Respondent Nos. 6 and 7 had granted exclusive leasing rights to Respondent No. 5. It was submitted that Respondent No. 5 subsequently agreed to refurbish the building and gave the premises to the Corporate Debtor on a monthly rent of Rs.10 Lakh for a period of 4 years. It was submitted that the Auditor has conducted searches for historical rent prices and assessed that the prevailing rent rate in 2014 in the locality would be Rs.38.18/- per sq. ft. and the rent paid by the Corporate Debtor was Rs.65/- per sq. ft. along with maintenance of Rs.6.50/- per sq. ft. It was submitted that the rent was overpriced by Rs.33.32/- compared to the average prevailing market rates between the period from 2014 to 2017.

6.4. It was submitted that it is unusual for a Company which is under financial stress to agree to pay rent collectively for 4 years at the above agreed rate which amounts to Rs.5.44 Crore between March 2016 to March 2017. Further, it was submitted that pursuant to a letter dated 01.09.2017, the lease agreement was terminated and the 5<sup>th</sup> Respondent was instructed to pay a sum of Rs.3.15 Crore to Tulsyan Smelters Private Limited and Rs.1.05 Crore to Tulsyan NEC Limited. It

was submitted that as per the books, a sum of Rs.4.2 Crore was adjusted with Tulsyan Group as mentioned above on 31.03.2018 and Rs.1.26 Crore was received by the Corporate Debtor from the 5<sup>th</sup> Respondent on 05.04.2016. The Learned Counsel for the Applicant submitted that such adjustment entries with Tulsyan Group raises concern on the genuineness of the rental agreement with the 5<sup>th</sup> Respondent. Further, it was submitted that the same highlights the potential relationship with Tulsyan Group and the purpose of underlying transactions and payments made to the related and potentially related parties.

**C. RUPAL RAI – 6<sup>TH</sup> RESPONDENT**

6.5. It was submitted that as per the lease agreement dated 01.10.2017, between the Corporate Debtor and the 6<sup>th</sup> Respondent (who is the wife of the 1<sup>st</sup> Respondent), who is the owner of the second floor measuring 3841 sq. ft. at Block I – 6/13 North Avenue, Kesavaperumal Puram, Chennai – 600 028, the said premises was given on rent to the Corporate Debtor from October 2017 for a period of 12 months at a monthly rent of Rs.65/0 per sq. ft. amounting to a monthly rent of Rs.2,49,665/-. However, considering the cancellation of previous lease agreement with the 5<sup>th</sup> Respondent due to

financial stress, a new agreement with the same owner the 6<sup>th</sup> Respondent for the same property at the same rate per sq. ft. was flagged as questionable by the Auditor.

**d. RITIKA RAI – 7<sup>TH</sup> RESPONDENT**

6.6. It was submitted that an amount of Rs.45 Lakh was paid to the 7<sup>th</sup> Respondent, who is the daughter of the 1<sup>st</sup> Respondent towards outstanding payable balance carried forward from the prior years. However, it was submitted that the Auditor has noted that there was no reason cited for the dues specified in the letter seeking the pending dues from the Corporate Debtor. It was submitted that the management clarified that he payments to the 7<sup>th</sup> Respondent was towards the rent for the year 2012, however the rent agreement was not provided for the Auditors perusal. Hence it was submitted that since the 7<sup>th</sup> Respondent is a related party, this transaction was not placed at the meeting of the board for necessary approval as per the provisions of Section 188 of the Companies Act, 2013

**e. RKKR STEELS LIMITED – 8<sup>TH</sup> RESPONDENT**

6.7. It was submitted that there was a sale of vehicle (Skoda Laura) to the 8<sup>th</sup> Respondent at Rs. 5 Lakh and the

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vehicle registration number of the said vehicle was incomplete in the invoice and the registration form, due to which the Auditor could not verify the ownership details. It was submitted that the Auditor was furnished with third party valuation annexed for the aforementioned sold car by the management, however the auditor could not rely on the same since the valuation of the cars was not undertaken at the time of sale.

**f. RAJIV RAI AND RITESH RAI – 1<sup>ST</sup> AND 2<sup>ND</sup> RESPONDENT**

6.8. It was submitted that during the review period payments of Rs.28 Lakh were paid to the 1<sup>st</sup> and 2<sup>nd</sup> Respondent and that these Respondents have decided to make these payments to themselves despite the existence of indebtedness to multiple creditors. It was submitted that the Respondents have replied that these payments were made towards directors' salaries and business promotion expenses, however it was submitted that these payments were made during the Financial years 2015 – 2016 and 2016 – 2017 but no expenses were book against these. Consequently, as per the Auditor, there is no rationale as to why the salaries of the Directors of the Corporate Debtor were adjusted with the balances of Radha Vyapar Limited.



7. The Learned Counsel for the Applicant submitted that on review of the books of the Corporate Debtor, the Auditor noted that there were unadjusted receivable balances in creditors account and there were instances of prior period carried forward receivable balance which were not adjusted during the Review period and instances of advance payments issued during the Review period not supported with relevant agreements, purchase orders and rational for issuance of advance.

8. In the light of the aforestated facts, and also by taking into consideration the Revised Audit Report, the Learned Counsel for the Applicant sought for declaration that the transactions are fraudulent and wrongful in nature and to direct the Respondent to make good the said loss.

**9. REPLY OF RESPONDENT NOS. 1 TO 8**

9.1. The Learned Counsel for the Respondent submitted that the Corporate Debtor had taken loans for the period 2008 to 2011 for setting up and running the operations of their Integrated Steel plant. It was submitted that during the said period the Supreme Court had banned Iron Ore mining in Karnataka in July 2011 and this forced the plant to stop its Blast Furnace operations and due to the same, the Corporate Debtor went in for Corporate Debt

Restructuring (CDR) in the year 2011. It was submitted that the said CDR plan was approved in early 2012 but the financial support to complete the pending 90 MW Power Plan and other pending manufacturing units was made available only by late 2012. The Learned Counsel for the Respondents submitted that the Corporate Debtor suffered during the said period and due to three factors viz. (i) steep power cuts in Andhra Pradesh, (ii) non availability of Iron Ore and (iii) Unrest in Telengana, which affected the movement of manpower and goods for months together in the coastal Andhra region. Hence, it was submitted that due to limited operations, the financial position got effected badly in the year 2013 with the entire working capital of the Company getting eroded resulting in the manufacturing process in units like Coke oven, Blast furnace, etc getting stopped by mid 2013. Subsequently, it was submitted that other plants such as steel melt shop and Rolling mill were also stopped due to lack of funds and support from lenders and this lead to the loans being terms as Non – Performing Assets again by mid 2013 and the Corporate Debtor was referred to the Board for Industrial and Financial Reconstruction in early 2014 simultaneously leading to 7 of the 9 banks to sell their loan portfolio in the Corporate Debtor to Edelweiss ARC which then held 85% of the secured debt of the Corporate Debtor.

9.2. The Learned Counsel for the Respondent further submitted that with the advice and approval of the Edelweiss ARC which held 85% of the secured debt, the management of the Corporate Debtor had decided to restart the DRI Plant & Captive Power Plant with the financial support of raw materials suppliers and decided to supply power to Government Utility Companies in Andhra and Telangana through Power Purchase agreement as there was a power shortage in Andhra Pradesh at that time. It was submitted that the Corporate Debtor had identified certain suppliers through whom they got the necessary key raw materials on creditor (Iron Ore and Coal) which they used and generated power in its CPP and produced Sponge Iron and sold it to the market. This decision to operate just a few units like power plant and DRI plant was taken by the management of the Corporate Debtor in the interest of all stakeholders including creditors as they could not run the entire plant without any fresh working capital assistance and this plan had the full consent of Edelweiss ARC.

9.3. The Learned Counsel for the Respondents submitted that the Edelweiss ARC being the key lender of the Corporate Debtor, all the Financial Statements were made available from 2013 – 2014 onwards and the provisions of impairment as per Accounting Standards – 28 was done with their knowledge, however no objections were raised by the Edelweiss ARC at any point of time. It

was submitted that the qualification made by the Statutory Auditor in the audit report is that, the adequacy of the provision with respect to AS-28 made by the Corporate Debtor is not ascertainable and hence it was submitted that questioning the validity of the qualifications raised by the Statutory Auditor qualifying the provisions made is not correct.

9.4. The Learned Counsel for the Respondents submitted that since the operations in certain units like Blast Furnace, Coke Oven & Sinter had been stopped abruptly in 2013, it was observed that damages had taken place to the refractories and these would require a capital expenditure before restart. Hence the management had to provide for impairment of Assets for those assets attributable to the discontinuing operations to be in compliance with AS-28 which is mandatory in nature. It was submitted that the management estimated the impairment loss of each plant of the discontinued operations and recognized the same in the books of accounts from the Financial Year 2013 – 2014 onwards in terms of AS – 28 issued by ICAI. Further, it was submitted that the factory is located near the coast which bears heavy saline air and since maintenance has been suspended when the plant was mothballed, it was noticed that many steel structures started getting rusted and over time would require replacement and hence an ongoing impairment was required to be made on these units which were lying shut since 2012 / 2013.

The Learned Counsel for the Respondents further submitted that the records were left unattended due to very few accounts team members within the organization and that the records were left unattended due to very few accounts team members within the organization. It was submitted that since the records needed to be scrutinized and verified for submission, it was hard to provide with the item – wise Fixed Asset Register initially to the Forensic Auditor. However, it was submitted that the Corporate Debtor had later submitted a detailed Fixed Assets Register along with an abstract containing Plant wise, Category wise assets along with year wise additions, disposals / impairment etc., till December 2017.

9.5. The Learned Counsel for the Respondents submitted that the Corporate Debtor is in steel industry business for over six decades and the impairment was arrived on the basis of the conditions of the plants as evaluated by the management and accordingly accounted for as impairment. The said AS – 28 does not warrant a third-party evaluation for impairment and considering the experience of the management and to avoid wasteful resources, no third-party evaluation was made.

9.6. The Learned Counsel for the Respondent submitted that for the Respondent Nos. 4 and 5, the Corporate Debtor first went into CDR in 2011 and then into Board for Industrial and Financial

Reconstruction in 2014 itself which lead it to suffer severe financial stress right since 2011. It was submitted that the intention was to pay the rent when the Corporate Debtor had obtained a reasonable financial status and hence the bills have not been accounted for the period. Moreover, it was submitted that the said payments made was also again to settle the dues of SBQ's operational creditors and Tulsyan Group being a major supplier of coal, which was very much required for power plant operations and the same has been accounted in the books.

9.7. In relation to the payments made to Shantananda Steels Limited for the FY 2016 - 2017 it was submitted that the cahs payments was reasonable only for that year. However, the said payments were made to Tulsyan and the rates mentioned in the agreement was also in par with market value and hence at arms length price. Further, it was submitted that there was no diversion of funds as the entire amount was paid to the Operational Creditor M/s. Tulsyan by Shantananda Steel and the same was acknowledged by the Forensics Auditors and the RP in this Application. It was submitted that the Tulsyan group was an Operational Creditor and not related to the Corporate Debtor. In respect of the vehicle, it was submitted that the same was a flood hit vehicle and was purchased



with an intention to use, however the repairs and maintenance costs for the vehicles was very high, the same was sold subsequently.

9.8. In relation to the transactions made with the 8<sup>th</sup> Respondent, it was submitted that the agreement for rent includes fully fitted out facility with furniture and storage for files, power back-up with UPS as well as DG power, data cabling, electrical fittings, central air-conditioning and maintenance costs. It was submitted that the said agreement does not have any other charges apart from the agreed amount and eventhough the agreement was entered in the month of October 2017, no payment were made to the said Respondent and that it was submitted that the rent in agreement was at arms's length pricing as can be seen from the certificate obtained from JLL, a leading global real estate agency.

9.9. In relation to the transactions made with the 7<sup>th</sup> Respondent it was submitted that the issue is pertaining to the rent payable for the premises occupied by the Corporate Debtor from 15.04.2010 onwards till October 2012 which is payable to the 7<sup>th</sup> Respondent and is in the ordinary course of business and which has been mentioned as outstanding in the financial statements periodically. It was submitted that since the 7<sup>th</sup> Respondent is mainly a house wife having no other income other than this, the said rental income, subject payments were to be made to her against the lease

deed entered into by the Corporate Debtor. Moreover, it was submitted that the management of the Corporate Debtor had requested the Respondent to use her husband's connection and ensure that it received the refund of payments due to it from the Supreme Court appointed Monitoring Committee which was mainly against the advances made for Iron Ore purchases from mines in Karnataka. Hence, by this way, the pending dues against the rent could be cleared to her and the Corporate Debtor would not feel the pinch of this cash outflow. It was submitted that since majority of the dues from the Monitoring Committee were received by the 7<sup>th</sup> Respondent using her influence, this payment which was for over 6 years and for which the company had already enjoyed the use of the premises was released to her. It was submitted that the payment was done during the ordinary course of business and not on any preferential basis. Further, it was submitted that the rent is an essential service and without payment of this, it would have become difficult for the Corporate Debtor to operate its corporate office from its central location.

9.10. In relation to the transactions made with the 8<sup>th</sup> Respondent, it was submitted that the quotes were obtained from M/s. Mahalingam and Sons who are the leading experts / dealers in the field of selling and buying of the used cars in Chennai and subject to the quotes the car was sold to the Respondent and hence the said

transaction had taken place during the normal course of business and were at arms length pricing. Simultaneously it was submitted that a certificate was obtained by T.S. Mahalingam & Sons towards valuation for used card.

9.11. In relation to the transactions pertaining to the 1<sup>st</sup> and 2<sup>nd</sup> Respondent, it was submitted that the issue is pertaining towards salaries and reimbursement of expenses and the bills and all supporting documents are made available have been submitted. It was submitted that the 1<sup>st</sup> and 2<sup>nd</sup> Respondent had put in enough efforts in trying to revive the operations of the Corporate Debtor for many years without drawing on the Board approved salaries, however significant expenses on travel, reimbursement of expenses had not ben booked in the Corporate Debtor's account, inadvertently and this anomaly was corrected by the statutory auditor before closing accounts for the period ended 31.03.2018. Under the said circumstances, the Learned Counsel for the Respondents have prayed for dismissal of the present Application.

## **10. FINDINGS OF THIS TRIBUNAL**

10.1. Heard the submissions made by the Learned Counsel for both the parties and perused the records including the pleading placed on record. As already alluded *supra*, the Applicant has filed the present Application under Section 66 of IBC, 2016. In this

context it is relevant to extract Section 66 of IBC, 2016, which is as follows;

**66. Fraudulent trading or wrongful trading. –**

(1) If during the corporate insolvency resolution process or a liquidation process, it is found that any business of the corporate debtor has been carried on with intent to defraud creditors of the corporate debtor or for any fraudulent purpose, the Adjudicating Authority may on the application of the resolution professional pass an order that any persons who were knowingly parties to the carrying on of the business in such manner shall be liable to make such contributions to the assets of the corporate debtor as it may deem fit.

(2) On an application made by a resolution professional during the corporate insolvency resolution process, the Adjudicating Authority may by an order direct that a director or partner of the corporate debtor, as the case may be, shall be liable to make such contribution to the assets of the corporate debtor as it may deem fit, if-

(a) before the insolvency commencement date, such director or partner knew or ought to have known that there was no reasonable prospect of avoiding the commencement of a corporate insolvency resolution process in respect of such corporate debtor; and

(b) such director or partner did not exercise due diligence in minimising the potential loss to the creditors of the corporate debtor.

(3) Notwithstanding anything contained in this section, no application shall be filed by a resolution professional under subsection (2), in respect of such default against which initiation of corporate insolvency resolution process is suspended as per section 10A.

10.2. A careful perusal of Section 66 of IBC, 2016 would manifest the fact that it deals with two transactions; Section 66(1) of

IBC, 2016 deals with 'Fraudulent Trading' and Section 66(2) of IBC, 2016 deals with 'Wrongful Trading'. Section 66(1) of IBC, 2016 imposes liability on 'any person' who were knowingly parties to the carrying on the business with a dishonest intention to defraud the creditors, to make contribution to the assets of the Corporate Debtor. Thus, essentially for a transaction to qualify under Section 66(1) of IBC, 2016, the following conditions should be satisfied;

- (a) Liability can be fixed upon 'any person';
- (b) The said person should knowingly carry on the business with the Corporate Debtor;
- (c) The said person should have a dishonest intention to defraud the creditors;

10.3. It can be seen that Section 66(1) of IBC, 2016 is *pari materia* to the provisions of Section 213 of UK Insolvency Act, 1986, which is extracted hereunder;

### **213 Fraudulent trading.**

(1) If in the course of the winding up of a company it appears that any business of the company has been carried on with intent to defraud creditors of the company or creditors of any other person, or for any fraudulent purpose, the following has effect.

(2) The court, on the application of the liquidator may declare that any persons who were knowingly parties to the carrying on of the business in the manner above-mentioned are to be liable to make such contributions (if any) to the company's assets as the court thinks proper.

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10.4. On analysing Section 66(2) of IBC, 2016 it is to be seen that it deals with 'Wrongful Trading' and for a transaction to qualify under Section 66(2) the following conditions must be satisfied;

- (a) Liability can be fixed upon only 'Director' or 'Partner';
- (b) They knew, or ought to have concluded that there was no reasonable prospect of avoiding insolvency proceedings;
- (c) They did not take due diligence with a view to minimising the potential loss to the company's creditors;

10.5. It can be seen that Section 66(1) of IBC, 2016 is akin to the provisions of Section 214 of UK Insolvency Act, 1986, which is extracted hereunder;

**214 Wrongful trading.**

(1) Subject to subsection (3) below, if in the course of the winding up of a company it appears that subsection (2) of this section applies in relation to a person who is or has been a director of the company, the court, on the application of the liquidator, may declare that that person is to be liable to make such contribution (if any) to the company's assets as the court thinks proper.

(2) This subsection applies in relation to a person if—

- (a) the company has gone into insolvent liquidation,
- (b) at some time before the commencement of the winding up of the company, that person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation, and
- (c) that person was a director of the company at that time;

but the court shall not make a declaration under this section in any case where the time mentioned in paragraph (b) above was before 28th April 1986.

(3) The court shall not make a declaration under this section with respect to any person if it is satisfied that after the condition specified in subsection (2)(b) was first satisfied in relation to him that person took every step with a view to minimising the potential loss to the company's creditors as (on the assumption that he had knowledge of the matter mentioned in subsection (2)) he ought to have taken.

(4) For the purposes of subsections (2) and (3), the facts which a director of a company ought to know or ascertain, the conclusions which he ought to reach and the steps which he ought to take are those which would be known or ascertained, or reached or taken, by a reasonably diligent person having both—

- (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company, and
- (b) the general knowledge, skill and experience that that director has.

(5) The reference in subsection (4) to the functions carried out in relation to a company by a director of the company includes any functions which he does not carry out but which have been entrusted to him.

(6) For the purposes of this section a company goes into insolvent liquidation if it goes into liquidation at a time when its assets are insufficient for the payment of its debts and other liabilities and the expenses of the winding up.

(6A) For the purposes of this section a company enters insolvent administration if it enters administration at a time when its assets are insufficient for the payment of its debts and other liabilities and the expenses of the administration.

(7) In this section "director" includes a shadow director.

(8) This section is without prejudice to section 213.

10.6. Thus, there seems to be a stark contrast in relation to Section 66(1) and 66(2) of IBC, 2016. It is needless to say that even the scope of sub – section (1) and (2) of Section 66 of IBC, 2016 are different. As to the present case, the Applicant sought the Respondents to make contribution to the Corporate Debtor, under Section 66(2) of IBC, 2016.

10.7. The essence of sub-section (2) of Section 66 of IBC, 2016 seems to be that the Directors and Partner should have acted reasonably and responsibly in the time preceding the company's insolvency to avoid wrongful trading proceedings. They must always have put creditors' interests first, and not work for their own benefit. In other words, the Creditor could recover the money from the Director or Partner, if they have traded irresponsibly and acted without care or consideration for the creditors and in doing so, increased the debts of the Company. In short, it is where directors continue trading despite being aware that the company is insolvent.

10.8. Further, sub-section (3) of Section 66 suspends the operation of sub-section (2) till such time the period as mentioned in Section 10A of IBC, 2016 is in force. Interestingly, the UK Insolvency Act, 1986 has also suspended Section 214 which deals with Wrongful Trading for the period from 01.03.2020 till

30.09.2020. The object behind inserting sub-section (3) in Section 66 of IBC, 2016 seems to be that the Directors and Partners of the Company may continue their business or trading during the Covid – 19 pandemic without having the risk of being prosecuted under wrongful trading. However, it may be noted that the same benefit of suspension is not granted to 'Fraudulent Trading' defined under Section 66(1) of IBC, 2016 and also under Section 213 of UK Insolvency Act, 1986.

10.9. For a transaction to qualify under sub – section (2) of Section 66 of IBC, 2016 the Resolution Professional has to substantiate before this Tribunal that the Director or the Partner of the Corporate Debtor is aware the company is insolvent and continues to trade and increases the debt of the Company. Further, it is to be noted that on examining Section 66(2) of IBC, 2016 the element of 'Fraud', 'dishonest intention' and 'defrauding the creditor' is conspicuous by its absence, as compared to Section 66(1) of IBC, 2016.

10.10. The definition of Wrongful Trading as found in Section 66(2) of IBC, 2016 is somewhat seems to be exhaustive since it does not clearly delineate as to which act committed by a Director or a Partner of the Company would constitute 'Wrongful Trading'. It is to be noted here that there is no significant Judgment of the Appellate

Tribunal and the Hon'ble Supreme Court in relation to the 'Wrongful Trading', in view of the fact that the concept of 'Wrongful Trading' is being imported from the UK Insolvency Act, 1986 into the IBC, 2016 which is still at a nascent stage in this Country. Thus, it becomes imperative for this Tribunal to refer to the decision of the English Court. Thus, by taking a cue from the judgments rendered by the English Court in this regard, the following acts, but not limited to, would amount to 'Wrongful Trading';

- (i) Repaying the director loan made to the company while other creditors were not paid;
- (ii) Repayment of a loan to a family member;
- (iii) A director paying his own salary whilst the salary for the employees was not paid;
- (iv) Buying goods on credit when there is no means to pay for them;
- (v) Using customer deposits for cash-flow purposes with no means of supplying goods;
- (vi) Repaying bank personal guarantees over other creditors;
- (vii) Not keeping proper accounting records;
- (viii) Falsification of company records;
- (ix) Any transfer or sale of assets at anything less than a fair and reasonable commercial value;

10.11. By keeping in mind the scope of sub – section (2) of Section 66 of IBC, 2016, this Tribunal is required to examine as to whether the transactions as alleged by the Applicant in the

present Application against the Respondents would fall within the confine of 'Wrongful Trading' that is to say that whether the Directors of the Corporate Debtor knew, or ought to have known that there was no reasonable prospect of avoiding insolvency proceedings; and that they did not take due diligence with a view to minimising the potential loss to the Company's creditors. In this context, it is significant to refer to the decision of the Supreme Court in the matter of **Anuj Jain IRP for Jaypee Infotech Limited –Vs- Axis Bank Limited Etc.**, in *Civil Appeal No. 8512 – 8527 of 2019*;

29.1. However, we are impelled to make one comment as regards the application made by IRP. It is noticed that in the present case, the IRP moved one composite application purportedly under Sections 43, 45 and 66 of the Code while alleging that the transactions in question were preferential as also undervalued and fraudulent. In our view, in the scheme of the Code, the parameters and the requisite enquiries as also the consequences in relation to these aspects are different and such difference is explicit in the related provisions. As noticed, the question of intent is not involved in Section 43 and by virtue of legal fiction, upon existence of the given ingredients, a transaction is deemed to be of giving preference at a relevant time. However, whether a transaction is undervalued requires a different enquiry as per Sections 45 and 46 of the Code and significantly, such application can also be made by the creditor under Section 47 of the Code. The consequences of under valuation are contained in Sections 48 and 49. Per Section 49, if the undervalued transaction is referable to sub-section (2) of Section 45, the Adjudicating Authority may look at the intent to examine if such undervaluation was to defraud the creditors. On the other hand, the provisions of Section 66 related to fraudulent trading and wrongful trading entail the liabilities on the persons responsible therefor. We are not elaborating on all these aspects for being not necessary as the transactions in question are already held preferential and hence, the order for their avoidance is required to be approved; but it appears expedient to observe that the arena and scope of the requisite enquiries, to find if the transaction is undervalued or is intended to defraud the creditors or had been of

wrongful/fraudulent trading are entirely different. 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 of the Code. As noticed, the scope of enquiry in relation to the questions as to whether a transaction is of giving preference at a relevant time, is entirely different. Hence, it would be expected of any resolution professional to keep such requirements in view while making a motion to the Adjudicating Authority.

10.12. From the above judgment of the Hon'ble Apex Court, it is to be noted that specific material fact in relation to the transaction which is sought to be challenged by the Resolution Professional is required to be pleaded in the Application. As to the present case, the Applicant sought to reverse the transactions purported to be done by the Respondents under Section 66 of IBC, 2016. Also in the present case, the Applicant has not specifically pleaded as to which transactions he is sought to be reversed under Section 66(1) of IBC, 2016 and which transactions falls under Section 66(2) of IBC, 2016.

10.13. From the averments and in the submissions made by the Applicant, it is seen that the Applicant is trying to make a sweeping allegation by stating that there were impairments of assets just simply by relying upon the Report of the Auditor. However, the Learned Counsel for the Applicant has miserably failed to prove that the Respondents have paid the money with a dishonest intention and to defraud the creditors. Further, the Applicant nowhere in the Applicant has stated as to how the Respondents was in the

knowledge that the Company is going to be insolvent and the Applicant has also miserably failed to substantiate that the Respondents have not taken diligent care to minimize the potential loss to the Creditors.

10.14. Further, the Hon'ble High Court of Himachal Pradesh in the matter of "**Hypine Carbons Limited -Vs- J.C. Bhatia and others**", decided on 13.11.1998 has held that;

34. Mere failure on the part of the Respondents to initiate legal steps against the debtors would not bring the case within the ambit of Section 542 of the Act, unless it is shown that the respondents had failed to do so with fraudulent intentions to defraud the creditors, or any other person(s), or for any other fraudulent purpose.

10.15. Hence for the aforesaid reasons, we find no merits in the present Application. Accordingly, MA/631/2018 stands **dismissed**. No costs.

-Sd-  
**B. ANIL KUMAR**  
MEMBER (TECHNICAL)

-Sd-  
**Justice (Retd.) S. RAMATHILAGAM**  
MEMBER (JUDICIAL)

*Raymond*