MINISTRY OF CORPORATE AFFAIRS

Monthly Newsletter

VOLUME - 43 June - 2021

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One of the primary objectives of the Insolvency and Bankruptcy Code, 2016 (Code) is maximisation of the value of the corporate debtor (CD). For some stakeholders, the exercise of value maximization stops at realization through the approved resolution plan. However, there are several other options including retrieval of value siphoned off through avoidance transactions.

The UNCITRAL Legislative Guide on Insolvency Law states that "provisions of the insolvency law that permit transactions for the transfer of assets or the undertaking of obligations prior to insolvency proceedings to be cancelled or otherwise rendered ineffective and any assets transferred, or their value, to be recovered in the collective interest of creditors". These transactions can fall into several categories. The 'preferential transaction' is about 'who', i.e., the debtor is being biased and is making payment to a creditor, to the exclusion of others, such that the creditor is wrongly benefitted, it amounts to a preference. While 'undervalued transactions' are about 'how much', where the value received by the debtor is less than the value compromised by the debtor. The scope of 'transactions to defraud creditors' is different from that of a preferential or undervalued transaction, in the sense that there is an element of deliberate intent, viz., the intent to defraud. For either preferential or undervalued transactions, intent does not matter. Further, an 'extortionate transaction' is one in which the debtor had to make exorbitant payments w.r.t the credit, or the terms were unconscionable under the principles of law relating to contracts. Like almost all jurisdictions namely UK, USA, China, Singapore, Australia, in India, the Code recognizes several 'avoidable transactions' such as the preferential transactions (Section 43), undervalued transactions (Section 45), transactions defrauding creditors (Section 49) extortionate transactions (Section 50) and wrongful and fraudulent trading (Section 66).

As regards the recovery from the vulnerable transactions, the Bankruptcy Law Reforms Committee observed that "If such transactions are established, then they will be reversed. Assets that were fraudulently transferred will be included as part of the assets in liquidation. The Committee recommends that all transactions up to a certain period of time prior to the application of the IRP (referred to as the "look-back period") should be scrutinised for any evidence of such transactions by the relevant Insolvency Professional. The relevant period will be specified in regulations." The Code enables reversal of avoidance transactions and thereby claw back the value lost through such transactions. If transactions are undone and the lost value is retrieved, the creditors stand to realise value from vulnerable transactions as well as from the existing assets. Higher the value creditors can realise from the corporate in stress, the higher is the likelihood of resolution of stress by a resolution plan, which is the primary objective of insolvency law in India. Further, the Code requires the beneficiaries of such transactions to disgorge the value, and thereby takes away the incentive to indulge in vulnerable transactions. Since such transactions are considered criminal in certain circumstances, particularly when it is fraudulent, it disincentivises a potential miscreant. Such incentives and disincentives are formulated to ensure that there is no vulnerable transaction. In such a case, value resides within the company and consequently, the possibility of a company getting into stress is less. In this sense, these provisions prevent stress, and stand to guard corporate governance.

The Insolvency Professional acting as Resolution Professional (RP) is entrusted with the responsibility to make sure that value of any asset of the CD lost on account of such vulnerable transactions is clawed back. The look back period or the twilight period prescribed under the Code is preceding two years for a transaction entered with related parties and preceding one year in case of transactions with others. There is no time period for reporting of a fraudulent transaction. While discussing the duties of an IP, the BLRC observed that "The IP makes sure that assets are not stolen from the company, and initiates a careful check of the transactions of the company for the last two years, to look for illegal diversion of assets. Such diversion of assets would induce criminal charges."

In the landmark judgment of Anuj Jain Interim Resolution Professional for Jaypee Infratech Limited versus Axis Bank Limited [Civil Appeal Nos. 8512-8527/2019], Hon'ble Supreme Court clarified upon the duties and responsibilities of the RP in respect of avoidance transactions. It further observed the parameters of each case is unique and different types of avoidance transactions are required to be examined differently.

On establishment of avoidance transaction, the Code has provided for both civil remedies and criminal charges. The power to grant civil remedies is entrusted upon the Adjudicating Authority (AA) that can pass such orders as mentioned under the Code while dealing with applications pertaining to avoidance transactions. Further, provision of criminal proceedings under section 66(1) of the Code is to set off alarm bells among the conspirators and set the tone for future behaviour of the perpetrators of crime.

In normal circumstances, when a company is in good financial health, a director's primary duty is to act in the best interests of the company by promoting shareholder's value in the company. However, when a company is insolvent, or is in the "twilight zone", the director is obliged to instead have primary regard to the interests of the creditors. This is because in an insolvency context, it is the creditors who have priority of economic interest in the company, rather than the shareholders. It is possible that the directors of the company in distress do not maintain due care or siphon off the funds of the company for their gain, once they know that onset of insolvency cannot be avoided. On 'Twilight zone' like situation, Chapter F of Section II of Part two of the UNCITRAL Legislative Guide mentions that "Insolvency proceedings (both liquidation and reorganization) may commence long after a debtor first becomes aware that such an outcome cannot be avoided. In that intervening period, there may be significant opportunities for the debtor to attempt to hide assets from creditors, incur artificial liabilities, make donations or gifts to relatives and friends or pay certain creditors to the exclusion of others. There may also be opportunities for creditors to initiate strategic action to place themselves in an advantageous position."

Section 66(2) of the Code makes the directors liable for the loss to the creditors that arise during twilight zone. The twilight zone begins from the time when a director knew or ought to have known that there was no reasonable prospect of avoiding the commencement of resolution till the company enters the resolution process. During this period, a director has an additional responsibility to exercise due diligence to minimise the potential loss to the creditors and he is liable to make good such loss. This incentivises the corporate as well as its promoters and managers to seek resolution in early days of stress when the possibility of resolution is higher.

Generally, when an avoidance transaction is undone, the underlying property returns from the beneficiary to the CD. Section 66(2) however, provides recourse against the director who made transaction, and not the beneficiary. This provision has been rarely used. If used, this would take away incentive of promoters to resist admission making the admission much faster and enable commencement of resolution process when chances of resolution are high.

The grave concern regarding possibility of substantial erosion of value of the Corporate Debtor through avoidance transactions is seemingly real. To ward off such threats, the Code provides robust framework for identifying avoidance transactions during lookback period of two years with a view to protect the interests of stakeholders of a CD. Retrieving the value not only augurs well with the value maximization principle but more importantly potentially serves as effective deterrent to corporate persons to refrain from unscrupulous practices.

The robust framework for identifying avoidance transactions to protect the interests of stakeholders of a CD is at the very heart of achieving one of the most important objectives of the Code - the resolution of insolvency while also ensuring maximisation of the value, preservation of the assets of the CD and safeguarding the interests of all stakeholders of the CD. The Code provides a comprehensive insolvency resolution framework and is armed with necessary provisions to deal with avoidance transactions and protecting the interests of the stakeholders of a CD who are aggrieved by such transactions.