

The adjudication of an avoidance application under the IBC can survive the CIRP of a corporate debtor

The Division Bench of the Delhi High Court (“**Delhi HC**”) in the case of *Tata Steel BSL Limited v. Venus Recruiters Private Limited & Ors., etc.*¹ has put to rest the issue on avoidance applications proceedings surviving the conclusion of corporate insolvency resolution process (“**CIRP**”) under the Insolvency and Bankruptcy Code, 2016 (“**IBC**”). The Delhi HC has held that the avoidance applications can survive even after the approval of the resolution plan in cases where the resolution plan does not account for these transactions.

What are avoidance transactions under the IBC?

IBC’s core purpose is value maximization of the assets of the corporate debtor by securing/ ensuring that assets are available for its creditors. However, when companies start approaching insolvency, its promoters most often attempt dissipating the assets to minimize their losses and by the time those companies are at the cusp of insolvency, they have negligible asset value and limited recovery prospects for creditors. To secure the interest of the lenders, the IBC provisions for avoidance transactions such as preferential transactions (Sections 43 and 44), undervalued transactions (Section 45 to 48), extortionate transactions (Sections 50 and 51) and fraudulent transactions (Section 49 and 66), are avoided during the CIRP of the corporate debtor.

Brief Facts

These proceedings arise out of Bhushan Steel’s admission into CIRP in July 2017, with Mr. Vijay Kumar Iyer as the resolution professional (“**RP**”). On March 20, 2018, the committee of creditors (“**CoC**”) of Bhushan Steel approved Tata Steel’s resolution plan. On May 15, 2018, the National Company Law Tribunal (“**NCLT**”), Delhi approved the resolution plan, and the plan was implemented. In the meanwhile, on April 9, 2018 the RP had filed an avoidance application under Section 25(2)(j), Section 43-51 and 61 of the IBC against Venus Recruiters and other respondents. Since the application was filed prior to the approval of the resolution plan (by the NCLT), the NCLT issued notice in the avoidance application.

Aggrieved that the NCLT issued notice in the avoidance application, Venus Recruiters filed a writ petition seeking a declaration that the proceedings borne out of the avoidance application are void and non-est since the CIRP of the Corporate Debtor had concluded and that Tata Steel (the successful resolution applicant) had already assumed control of the Corporate Debtor.

¹ 2023/DHC/000257 dated January 13, 2023

The Ld. Single Judge, Delhi High Court² held that the avoidance applications under Section 43 of the IBC cannot survive the conclusion of the CIRP against a Corporate Debtor. Aggrieved, Tata Steel filed an appeal before the Division Bench.

The Division Bench formulated 3 (three) issues for determination in the appeal: (i) whether an alternate and efficacious remedy existed before the National Company Law Appellate Tribunal (“NCLAT”); (ii) whether the avoidance application survive CIRP in cases where resolution plans are unable to account for such applications; and (iii) if avoidance applications survive CIRP in such cases, who pursues them? Whether the RP is rendered *functus officio* upon the conclusion of CIRP.

Issue

Whether the investigation of avoidance applications survive the period of CIRP in cases where the resolution plans are unable to account for such applications (including the modalities of such survival)?

Findings and Rationale

The Division Bench set aside the decision of the Ld. Single Judge and directed the NCLT to proceed with the hearing of the avoidance application in accordance with Section 44-51 of the IBC, with the amount recovered thereunder to be distributed amongst the secured creditors in accordance with law – as determined by the NCLT. The rationale for this conclusion is detailed below.

Survival of avoidance application after conclusion of CIRP

Avoidance applications can be adjudicated notwithstanding the conclusion of the CIRP, since:

1. CIRP and avoidance applications, are, by their very nature, a separate set of proceedings. The former, being objective in nature, is time bound whereas the latter requires a proper discovery of suspect transactions that are to be avoided by the adjudicating authority. The scheme of the IBC reinforces this difference and thus, adjudication of an avoidance application is independent of the resolution of the corporate debtor and can survive CIRP.
2. While the IBC mandates a resolution plan to provide for treatment of avoidance applications, if these are pending during the submission of resolution plans, the avoidance applications cannot be rendered due to exigencies that delayed initiation of action in respect of avoidable transactions beyond the submission of a resolution plan before the adjudicating authority. Such an interpretation will render the provisions on suspect transactions otiose and let the beneficiaries of such transactions walk away, scot-free.
3. Transactions in respect of which the RP has already applied for prosecution of avoidance applications cannot be accounted for and they need to adjudicating authority would continue to hear such applications. The resolution applicant cannot be given benefit of these transactions by not accounting for it in the plan, but instead, ought to have been cognizant of the pendency of the avoidance applications.

Till what stage can an avoidance application can be entertained?

Avoidance application can be filed even after the resolution plan is filed before the adjudicating authority and till the approval of the plan. In such cases, treatment of avoidance applications should be incorporated in the plan or otherwise adjudicating authority will direct the treatment as necessary.

² Judgement and order dated November 26, 2022 in WP (C) No.8705 of 2019 (Venus Recruiters Private Limited v. Union of India & Ors.)

Modalities of investigating avoidance applications after conclusion of CIRP

1. **RP not being functus officio:** The RP will not be functus officio for perusing the avoidance applications and can continue to pursue such applications. There being a clear demarcation between the scope and nature of the CIRP and avoidance application within the scheme of the IBC, the RP can continue to pursue such applications. The method and manner of the RP's remuneration will be decided by the NCLT itself.
2. **NCLT/ NCLAT to adjudicate the avoidance applications:** It is only appropriate that such applications are heard and adjudicated by the adjudicating authority, i.e., the NCLT or the NCLAT, as the case maybe, notwithstanding that the CIRP has concluded and the resolution applicant has stepped into the shoes of the promoter of the erstwhile corporate debtor. This is borne out of the phrases "arising out of" or "in relation to" in Section 60(5)(c) of the IBC having a wide import.
3. **Benefit from avoidance applications be given to creditors of the erstwhile corporate debtor.**
In cases where treatment of avoidance applications could not be accounted in the plan, the benefit (if any) from the adjudication of avoidance applications must be given to the creditors of the corporate debtor for the following reasons:
 - a) Money borrowed from creditors is essentially public money and the same cannot be appropriated by private parties by way of suspect arrangements, thus, any benefit accrues out of avoidance applications must be for the benefit of creditors of the erstwhile corporate debtor.
 - b) The amount made available by the adjudication of avoidable transactions cannot go to the kitty of resolution applicant or to the corporate debtor in its new avatar, since it does not continue as a debtor and has gone through the process of resolution.
 - c) This amount should be made available to the creditors who are primarily financial institutions and have taken a haircut in agreeing to accept a lesser amount than what was due and payable to them.
4. **Manner of distribution:** The manner of distribution out of the avoidance applications amongst the secured creditors will be in accordance with law as determined by the NCLT.

JSA Comment

1. **This decision is a welcome development for the avoidance transaction regime under IBC.**
 - a) **Letter and spirit:** As the Union of India had pointed out, accepting the Single Judge's interpretation would allow those persons responsible for the corporate debtor's liquidation because of their unscrupulous transactions will get away with their deeds. The scheme of IBC is not purely commercial in nature and its purpose is also to ensure that public money is brought back into the system.
 - b) **Practically:** The IBC stipulates the conclusion of CIRP in 330 (three hundred thirty) days and the liquidation process within 365 (three hundred sixty five) days. Within these timelines, most often the RP/ liquidator are unable to identify avoidable transactions and apply to the NCLT to reverse them. Even the NCLT, most often, cannot decide the issue before the resolution plan is approved. The purpose of avoidance transactions is to prevent unjust enrichment of one party at the expense of the other and recognizing that the detection and adjudication of such transactions can take longer than the entire CIRP is furtherance of spirit of avoidance provisions in the IBC.
2. **The CIRP (Fourth Amendment) Regulations.** This decision also takes note of the amendment being introduced w.e.f. May 14, 2022, stipulating that a resolution plan submitted after May 14, 2022, to provide for treatment of post-approval avoidance proceedings, and it proceeds. The Delhi High Court now clarifies

that even for resolution plans approved *prior* to the CIRP (Fourth Amendment) Regulations, 2022 which do not provide for treatment of avoidance application and its proceeds, its adjudicated dues must be appropriated to the creditors of the erstwhile corporate debtor.

3. **RP's timelines for filing avoidance applications are directory, not mandatory.** The timelines under Regulation 35A of the CIRP Regulations, 2016 for RP to file avoidance applications were held to only be directory in view of: (i) the practical difficulties of the RP collating information and forming an opinion on the transactions; and (ii) IBC does neither stipulates a penalty, nor timelines for the filing/ adjudication of these applications.
4. **Maintainability of a writ against the NCLT Order.** The Delhi High Court also decides on the NCLT having the power to adjudicate on all matters '*arising out of*' and '*in relation to*' insolvency resolution, which terms were interpreted broadly to even include avoidance applications, notwithstanding the approval of a resolution plan. Accordingly, the NCLAT was found to be the appropriate forum to entertain an appeal against the NCLT order and the Division Bench found that the Single Judge erred in entertaining the writ petition.

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