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# **CREDITOR'S RIGHTS UNDER IBC, 2016 FOR AVOIDABLE TRANSACTIONS: A CRITICAL ANALYSIS**

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## **ABSTRACT:**

*Immoral and unethical corporate practices which help escape liabilities and debts, have been a growing phenomenon in India over the past few years. In light of recent events, the laws and rules pertaining to these have been severely enhanced. The Insolvency and Bankruptcy Code, 2016 provides for such practices under the head of 'Avoidable Transactions'. The professionals appointed under the Code are instilled with the duty of recognising and reporting such transactions. However, there does exist a lacuna in cases where the Insolvency Professional's fail to carry out their duty. Creditors being the largest stakeholders have been given certain rights to approach the legal authorities in case of such failures. Yet, there exists an inadequacy as these rights are extremely limited and do not uphold the purpose and objective of the Code.*

*This paper thus deals with the critical analysis of the rights of these large stakeholders in relation to the defrauding transactions carried out by the corporate debtors. It highlights the inferences by legal bodies and legislative committees and provides a two-fold approach to this developing concept and its insubstantial applicability.*

## **I. INTRODUCTION**

The four types of *Avoidable Transactions*<sup>1</sup> provided under the Insolvency and Bankruptcy Code, 2016 are intended to defeat, hinder or delay creditors from collecting their claims.<sup>2</sup> These transactions change the financial position and credibility of the corporate debtor who otherwise may not need the rigorous insolvency procedures at all.

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<sup>1</sup> Anuj Jain v. Axis Bank Limited and Ors, MANU/SC/0228/2020 (India).

<sup>2</sup> United Nations Commission on International Trade Law, UNCITRAL Legislative Guide on Insolvency Law: (New York: United Nations, 2005). available from [https://www.uncitral.org/pdf/english/texts/insolven/05-80722\\_Ebook.pdf](https://www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf) at pg.141 ¶170.

Under §45(2) of the Code<sup>3</sup>, a transaction is considered as ‘undervalued’ if it is in the form of a gift *or* the consideration of which is significantly lesser than the value of consideration provided by the corporate debtor. Such a transaction takes place outside the ordinary course of business of the corporate debtor<sup>4</sup>. The Resolution Professional has the responsibility of protecting and preserving the assets of the debtor<sup>5</sup>, thus it is the duty of the RP to file an application for avoidable transactions under §25(j) of the Code. In addition to this, Regulation 35A of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016<sup>6</sup> prescribes a timeline for the RP to carry out the necessary requirements and file an application for the avoidable transactions.

In addition to this, the Code also provides a remedy to the creditors in case the professional fails to carry out his duties. Section 47 of the Code allows a creditor to file an application to reverse the effect of an *undervalued transaction*. However, this is a conditional provision under the Code, which only permits such an application if the *Resolution or the Liquidator* has erroneously not reported it to the Adjudicating Authority.<sup>7</sup>

## II. ANALYSIS

While providing a useful remedy to the creditors in vain, its ambit and nature has been widely debated. The underlying reason being that it does not include any other avoidable transaction and is barred by the limitation of time under Section 46 of the Code. Additionally, the nature of such transactions and the objective of the Code suggests that a creditor must not be allowed to challenge such transactions independently, thus conferring the right *exclusively*<sup>8</sup> to the professionals. This is considered essential to carry out fair and equitable proceedings considering the nature of such grave allegations and the penalties that come with it.

The nature and scope of each avoidable transaction prescribed under the Code differs from the others. There are different set of parameters to adjudge each such transaction. For this the

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<sup>3</sup> The Insolvency and Bankruptcy Code, 2016, No. 31, Acts of Parliament, 2016 (India).

<sup>4</sup> Sec. 45(2), The Insolvency and Bankruptcy Code, 2016, (India). See also, Pandurang v. Vishwanath, AIR 1939 Nag 20 (India).

<sup>5</sup> Sec. 25(1), The Insolvency and Bankruptcy Code, 2016, (India). See also Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta and Ors. (2019) 8 MLJ 524. (India).

<sup>6</sup> Reg.35A, The Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016. (India).

<sup>7</sup> Sec. 47, The Insolvency and Bankruptcy Code, 2016, (India).

<sup>8</sup> Report of the Insolvency Law Committee, Feb. 2020.

requisite enquiries as well as the consequences differ. Material facts are required to prove each transaction and each parameter of such transactions as well.<sup>9</sup> This makes it essential for a professional to oversee such transactions. This will not only prevent frivolous applications but also ensure that the correct requirements are adhered to. Contrary to this, it has been perceived that *some transactions may have the characteristics of more than one of these different classes, depending upon the individual circumstances*.<sup>10</sup> Though there are certain variants distinguishing the transactions, they are based on common objectives<sup>11</sup>. Accordingly, the remedy shall not be limited only to one class.

Some experts also believe that bestowing an independent right may invite multiple baseless applications by multiple creditors. Such vexatious applications will also result in inordinate delays of the judicial time if they are not backed by sufficient evidence to support them. This may also disrupt the stipulated time for the CIRP process.<sup>12</sup>

On the other hand, it is argued that if the IP does not diligently carry out his obligations and fails to report transactions of such grave nature, the creditors have no remedy to bring up applications against the other avoidable transactions. Additionally, invoking such provisions for irregular transactions may result in recovery of assets or their values which will not only benefit the creditors but also promote fair commercial conduct<sup>13</sup> and commercial morality.<sup>14</sup>

Thus, it is observed that with the development of this sector, there exists a lacunae in the rights provided to creditors pertaining to Avoidable Transactions. However, it is believed that ambiguity will be resolved with the development of the Code and its practical application with time. The Hon'ble Supreme Court has also laid emphasis on the need of the authorities to be attentive towards the objective of the code and has recently acknowledged that the Code is a new legislation which is still *progressing to take a proper shape*.<sup>15</sup>

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<sup>9</sup> Anuj Jain v. Axis Bank Limited and Ors, MANU/SC/0228/2020 (India).¶29.1

<sup>10</sup> United Nations Commission on International Trade Law, UNCITRAL Legislative Guide on Insolvency Law: (New York: United Nations, 2005). available from [https://www.uncitral.org/pdf/english/texts/insolven/05-80722\\_Ebook.pdf](https://www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf) pg.141 ¶170.

<sup>11</sup> ASHISH MAKHIJA, INSOLVENCY AND BANKRUPTCY CODE OF INDIA (1st ed.).

<sup>12</sup> Anuj Jain v. Axis Bank Limited and Ors, MANU/SC/0228/2020 (India).

<sup>13</sup> United Nations Commission on International Trade Law, UNCITRAL Legislative Guide on Insolvency Law: (New York: United Nations, 2005). available from [https://www.uncitral.org/pdf/english/texts/insolven/05-80722\\_Ebook.pdf](https://www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf) ¶152 pg.136.

<sup>14</sup> The Interim Report of the Bankruptcy Law Reform Committee, Feb. 2015.

<sup>15</sup> Anuj Jain v. Axis Bank Limited and Ors, MANU/SC/0228/2020 (India).¶29.3