ANTECEDENT TRANSACTIONS UNDER THE COMPANIES ACT AND IBC: A COMPARATIVE ANALYSIS OF AVOIDANCE MECHANISMS

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Introduction

The Insolvency and Bankruptcy Code (IBC), 2016 was introduced the concept of avoidance or antecedent transactions which was kept in line with the global practice in the realm of insolvency laws. In IBC, a series of transactions can be undone or avoided, the Resolution Professional or the liquidator who oversees the management can during the insolvency process simply making an application to the Adjudicating Authority.[1] The paper will tries explaining the laws in India regarding the avoidance transaction and the economic rationale and explore jurisprudence evolved behind the same via landmark judgements.

Avoidance transactions include transactions like Preferential, Undervalued, Fraudulent, and extortionate transactions which are stated under Sections 43 to 51 of the Code. Each transaction is of different nature and the impact each transaction creates is almost the same as they all deplete the assets of the corporate debtor.[2] Recently, various records were released by IBBI or the Insolvency and Bankruptcy Board of India which showed a total of Rs. 2.2 lakh crores worth of applications for avoidance transactions has been received by them recently.

The concept can simply be understood with help of a simple example. If a company A is under insolvency process, the company will generally have creditors whose dues are not yet paid against A. The promoter of the company A, just before starting the insolvency process sell assets of the company A at lower price then what it is worth. For instance, it can be a building owned by A whose real value is Rs. 1 crore but promoter sells it for only Rs. 50 lakhs and is sold to a known person by the promoter. The effect such transaction creates is that the creditors loaned money to A for it to purchase the building is left with just Rs. 50 lakhs to distribute

[1] Akaant Mittal, Issues Under the Insolvency and Bankruptcy Code Prior to Admission, Vol 60, J.I.L.I, 161-188 (2018)
[2] Anumeha Agrawal, Position of Operational Creditor under IBC, Vol.2, CORP. LAW. ADV, 150-165 (2018)

among themselves. In such scenario, Rs. 1 crore should be realised by the creditor. To negative the effect of such kind of undervalued or avoidance transaction, the liquidator files an application with Adjudicating Authority which will reverse such a transaction.

Avoidance Transaction: How to curb it under Indian Law?

The avoidance transaction main goal is to undo the prior transactions that were undertaken to benefit the creditors whose interests were harmed and by such kind of transactions the Code and who tries to maximise the valuation of the assets of the Corporate Debtor and provides more protection to the creditors.[3] There are four types of avoidance transactions provided under the code which are Preferential as mentioned under Section 43 of the Code, Undervalued as mentioned under Section 45 of the Code, Fraudulent as mentioned under Section 66 of the Code and Extortionate Credit Transaction as mentioned under Section 50 of the Code. These transactions are also referred as PUFE transactions.

a) Preferential Transaction:

Section 43 of IBC, 2016 defines transactions as a "preferential transaction" if the transaction is related to the transfer of property or in the interest of the Corporate Debtor for benefit of the creditor, surety, or guarantor 'in relation to an antecedent debt' and if such transaction has the effect of putting the creditor, surety, or guarantor in a beneficial position in the distribution of assets as prescribed under Section 53 of the IBC. The transaction must have taken place atleast two years prior to the insolvency commencement date in such cases of a related party or one year otherwise.[4] However, the IBC does not mention when a "debt" should be treated as "antecedent" debt. The term "antecedent" means "come before" or "prior or preceding in point of time." "Antecedent debt" means obligation that comes before making any kind of transfer. The simplest example that can be given is that when a payment is received against what is already owed.

The phrase "Antecedent Debt" was used by the Privy Council in the case of ***Suraj Bunsi Koer v. Sheo Persad Singh and Ors.***[5] In Privy Council judgement, ***Brijnarain v. Mangala Pd***[6]***.,***

[3] Department of Trade: Insolvency Law Review Committee, Report of the Kenneth Cork Advisory Committee 1976, 176, 1982.
[4] Ashish Pandey, The Indian Insolvency and Bankruptcy Bill: Sixty Years in the Makinh, 8, IMJ 25 30-45 (2016)
[5] (1880) ILR 5 CAL 148
[6] (1924) 26BOMLR 500

Lord Dunedin defined antecedent debt as "antecedent in fact as well as in time" which means that when two conditions which are necessary for debt to qualify as an antecedent debt are that the debt must be prior in time.

The makers of IBC were influenced by United Kingdom's Insolvency Act of 1986 and the concept of avoidance of preferential transfer is borrowed from the United States Bankruptcy Code. Section 239 of the UK Insolvency Act deals with preferential transactions and defines preference as that type of transaction which is made by the debtor within 2 years of the insolvent date and which appears to have put the creditor in a better position than which they would have been. The provision does not specify that the transfer or payment must have been made on account of the antecedent debt.

Antecedent dent is nowhere defined in the United States Bankruptcy Code. Section 101 of the U.S. Bankruptcy Code defines claims and in the same provision it is mentioned that det is a liability on a claim. In ***Re Girard***[7] case, the United States Bankruptcy Court while dealing with the issue of an avoidable preferential transaction observed that "*the term 'antecedent debt' is not defined under the Bankruptcy Code. Thus, the Court will look to the plain meaning of these two words for the answer. The term 'debt,' however, is defined under Section 101(12) as a "liability on a claim." Black's Law Dictionary defines 'antecedent debt' in the bankruptcy context as: "A debtor's prepetition obligation that existed before a debtor's transfer of an interest in property."*

In the case of ***Anuj Jain Resolution Professional for Jaypee Infratech Ltd. v. Axis Bank Ltd.***[8] ***[2020],*** while discussing the intent and scheme of preferential transactions under the IBc, observed that Section 43 is a deeming fiction as the provision contains the phrases "*deemed to have given a preference"* and "*deemed to be given at a relevant time"* and excludes the need of establishing intent. Thus, if the ingredients of a preferential transaction are fulfilled in a transaction, then the preference would be deemed to be given by the Corporate Debtor to the creditor. The Hon'ble Supreme Court in the case of ***Anuj Jain's***[9] verdict, the National Company Law Tribunal, New Delhi and in the case of ***GVR Consulting v. Pooja Bahry***[10]**,** held that any transaction entered by Corporate Debtor would be a preferential transaction only if it

[7] Case No. 03-23711, Adv. Proc. No. 04-2053
[8] (2020) 8 SCC 401
[9] (2020) 8 SCR 291
[10] (2023) SCC OnLine NCLAT 220.

fulfils the conditions as prescribed under the IBC irrespective of whether such transaction was in fact intended or anticipated to be so.

b) Undervalued Transaction:

Section 45 of the IBC deals with this and says tha transactions are considered as undervalued if the debtor makes gift to someone or when they transfer assets to someone for price significantly less than what the assets are worth. These types of transaction should not be undertaken under the ordinary course of business. The lookback period for such transactions is mentioned under Section 46 of IBC which is around two years in cases of related party and one year in case of non-related party transactions.[11]

An application can be filed as per Section 47 of the IBC for avoidance application and such application can be filed with the adjudicating authority by the creditor, member, or partner of a debtor if the Resolution Professional fails to do so.

Such type of transaction is entered into by the corporate debtor with the objective of reducing the value of the liquidation estate and causing wrongful loss to the creditors by eluding the chunk of proceeds that could have formed part of the claim. The IBC does not investigate the intent of the corporate debtor while such transactions are entered by and such transactions are generally entered into who requires a liquid asset for a specified period in good faith and would be brought under the scrutiny of the Adjudicating Authority if the consideration was less than what he had paid for and such transaction was entered into in the restricted timeline as given under Section 46 of IBC. An Illustration to understand undervalued transaction:

"X, the corporate debtor bought 1000 shares of a company at Rs. 1,00,000 in 2018. X sold all these shares at Rs. 50,000 in 2024 at a discounted price due to the requirement of liquidity. X goes into CIRP in 2025. The said transaction, even though it was done in good faith, would come under the purview of undervalued transactions."

These transactions were discussed in the landmark case of ***IDBI Bank Limited v. Jaypee Infratech Limited*[12],** the tribunal in this case held that if the corporate debtor mortgages an immovable property without any consideration, then such mortgage is considered as an

[11] Given in the case of Dipti Mehta v. Shivani Amit Dahanukar, 2019 SCC OnLine NCLT 5754
[12] 2018 SCC OnLine NCLT 13984

undervalued transaction. In another case of NCLT Mumbai, ***Ambit Finvest Pvt. Ltd. v. Rakesh Niranjan Ranjan and Ors.***[13]**,** the NCLT ruled that the Financial Creditor cannot file an avoidance application for PUFE except for in case of undervalued transactions because an application can be filed by a creditor, member, or partner of a Corporate Debtor.

In UK, the Insolvency Act of 1986 operates in the same way as it does in India. The scheme has obviously evolved with growing times. The Courts have interpreted the provision to give a wider aspect of the term considered to give regard to the change that is bound to happen in the value of assets. In the case of ***Reid v. Ramlort***[14]**,** the court said that there is a requirement of a nuanced valuation technique in cases where surrender value differed from the actual value.

A basic distinction between the two jurisdictions i.e., India and UK are that UK takes into consideration the good faith of the parties related without relying strictly on the statutory provision. In India, the legislative has failed to cater the current needs to make a liberal interpretation of the statute ground for equity and justice.

c) Fraudulent Transaction:

Section 66 of the IBC talks about Fraudulent Transaction. As per this section "any person" who is liable or has been knowingly a party to the transaction which undertook with the intent to defraud the creditors or for fraudulent purpose. This section also mentions that if the director or the partner of the corporate debtor is directed by the adjudicating authority to contribute to the assets of the corporate debtor if they were aware that there would have been no reasonable chance of avoiding insolvency and they failed to exercise due diligence to minimise potential losses to the creditors. It is assumed that proper due diligence was done and they acted with the level of care expected from someone in their position.

In the case of ***Mr. Thomas George v. K. Easwara Pillai and Ors.***[15]**,** NCLAT held that there is no specified lookback period for fraudulent transactions, and a three-year limitation period under the Limitation Act will not be applicable in such cases. Hence, the Resolution Professional can look back any time preceding the insolvency commencement date for the purpose of determining the fraudulent transactions. In another case, ***Shri Baiju Trading and***

[13] (2022) SCC OnLine NCLT 167
[14] VLEX 793356941
[15] (2021) SCC OnLine NCLAT 4636

***Investment Pvt. Ltd. v. Mr. Arihant Nenawati*[16],** the NCLAT observed and discussed what is 'fraud' for the purpose of Section 66 of IBC. In this case, Corporate Debtor was engaged in the bullion trading and faced insolvency due to certain defaults in payment of INR Rs. 4.9 crores to Raksha Bullion. The applicant owed INR 41.03 crores to Corporate Debtor, which was written off by debtor's directors before initiation of the CIRP. Resolution professional in this case alleged that this transaction was written-off as fraudulent transaction under Section 66 of the IBC and seeks contributions to the assets of the debtor. NCLT found that the transactions to be fraudulent and ordered contributions from the appellant and the directors. The NCLAT observes that the term 'fraud' contained in Section 66 would consist of debts that the debtor had no intention or ability to repay or it could also happen on false representation of the repayment intent. The usage of the phrase "any person" would include all the knowing parties who took part in the fraudulent transaction. The NCLAT held that the transactions which lack any security as interest or lacks any kind of bank guarantee as collateral for the Corporate Debtor and are written off and can only be considered fraudulent acts intended to deceive the creditors of Corporate Debtor.

The Moratorium Effect: In the case of ***Rakesh Kumar Jain v. Jagdish Singh Nain and Ors.*[17],** the NCLAT ruled that proceedings under Section 66 of IBC can be initiated against the Resolution Professional of a company undergoing CIRO and is not barred under Section 14 of IBC. The issue involved in this case was that whether during moratorium imposed under Section 14 of IBC, the Adjudicating Authority could pass an order under Section 66 of the IBC or not. The NCLAT stated that the bar imposed by Section 14 does not prohibit passing an order against the Resolution Professional and its suspended directors and related parties.

In UK, the Insolvency Act of 1986[18] aims at hindering the creditors and the fraudulent transactions as well and such are dealt under Sections 423 and 213 of the Act and these allows for recovering the assets and potentially criminal prosecution if caught. There is another act in UK which deals with such transactions which is the Fraudulent Conveyance Act of 1571.

d) Extortionate Credit Transactions:

Section 50 of IBC deals with this type of transaction. Any type of transaction whose term

[16] (2023) SCC OnLine NCLAT 405.
[17] (2022) SCC OnLine NCLAT 405.
[18] United Kingdom Insolvency Act 1986 c.423 and 123

requires exorbitant payments by the corporate debtor to be considered as an extortionate credit transaction. The lookback period for this type of transaction is two years and irrespective whether the parties are related or not.

In the case of ***Shinhan Bank v. Sugnil India Private Limited***[19]**,** the Allahabad NCLT gave certain instructions in relation to such transactions. The ban held 14.96% of the voting rights in the Committee of Creditors and challenged status of other COC members as financial creditors. They claimed that to be an FC based on any unsecured loans given to Corporate Debtor with interest rate of 65% pr annum. The bank argued that the interest rate was extortionate and above market standards. They want to set aside the debts as illegal credit transaction sunder Section 50 of IBC. The respondents argued that their transactions with the Corporate Debtor did not qualify as extortionate under Regulation 5 of the IBBI Regulations of 2016 as the interest rates were agreed by all the parties. The NCLT held that the interest rate was exorbitant and way above market standards which was around 24% per annum. Such rates qualified it as extortionate under the IBC. The tribunal also said that if the Corporate Debtor is involved in extortionate transactions, the Resolution Professional must identify and avoid them. In this case, the RP fails to do so and thus the bench decided to set aside the debt created from such extortionate transactions.

Avoidance Application Can Continue Even after CIRP

IBC does not specify any time limit for the adjudication of Avoidance Transactions and their applications, there have been application where Corporate Resolution Insolvency Process or the CIRP was concluded and resolution plans was approved, while such applications stood pending before NCLT. To avoid such situation, the matter was finally decided in the landmark case of Delhi High Court i.e., ***Venus Recruiters Ltd. v. Union of India and Ors***[20]**.** were the court held that the NCLT would not have any jurisdiction to entertain and decide Avoidance Applications after the resolution plan is approved or unless a provision is made to the contrary in the resolution plan. The case was challenged in front of a division bench in another case of ***Tata Steel BSL Ltd. v. Venus Recruiters Pvt. Ltd. and Ors.***[21] here the court held that the avoidance applications will be available even after the resolution plan is approved and if the plans do not account for such applications, then it can be heard even after CIRP is concluded.

[19] (2019) SCC OnLine NCLT 27541
[20] AIR OnLine 2020 DEL 1563
[21] 2023/DHC/000257

In this case, the RP filed for avoidance application under various sections of IBC after completion of CIRP against the respondent and various other parties. The NCLT issued notices and said that they were filed before the plan was approved. The Respondents got a writ from the Delhi High Court to declare the avoidance application proceedings to be held as void as CIRP is over and Successful Resolution Applicant or SRA had taken control of the Corporate Debtor. The court ruled that an application under Section 43 of IBC[22] cannot survive beyond the conclusion of CIRP. The court said that CIRP and avoidance applications are distinct proceedings and that CIRP is a time bound process and the applications are done via investigation and that the IBC allow such applications to be addressed independently. The court emphasised on the fact that "*the avoidance applications prevent beneficiaries of suspect transactions from escaping unscathed and such applications should be heard even if they were not accounted for in the resolution plan due to timing issues*." The court finally held that the RP continues to have a role in Adjudicating avoidance applications and their remuneration should be decided by the Adjudicating Authority.

The United Kingdom and the United States and in Singapore also has the same stand as India in this context, where under Section 423 of the Insolvency Act of 1986[23] it is stated that the avoidance application can continue or start even after the insolvency process of a company has commenced.

In India, in another case filed before the ***Tata Case in the Mumbai NCLT*[24]** it was held that the avoidance applications cannot be pursued after the approval of the resolution plan.

The case was ***State Bank of India v. Ushdev International Limited.*[25]** The tribunal referred to Regulation 35A of the IBBI Regulations, 2016 which mandates that within 130 days after insolvency process commences, the Resolution Professional must apply to the Adjudicating Authority for appropriate relief and if there are transactions covered under Sections 43, 45, 50 or 60 of IBC. The Tribunal also said that post-approval of the resolution plan, the debtor is now managed by a new management and the RP becomes Functus Officio and loses its authority. The Tribunal rejected the application and noted that RP could not pursue avoidance application

[22] The Insolvency and Bankruptcy code, 2016 c.45
[23] United Kingdom Insolvency Act of 1986 c. 423
[24] Case Number CP No. 82/2016
[25] (2019) ibclaw.in 254 NCLT

after resolution plan's approval and the change in debtor's management.

Composite Applications for Avoidance Transaction

The Apex Court of India in the Case of ***Anuj Jain (Supra),*** dealt with the question of composite applications for avoidance transaction. In this case the facts pleaded by the resolution Professional was related regarding the preferential transaction which covered under Section 43 of IBC. It was contended that the transaction should be held as void under Sections 45 and 66 of IBC. The court here emphasised on the fact that the ingredients of preferential transactions are distinct from undervalued and fraudulent transaction and pointing out that the Section 43 of IBC must create a legal friction to be pursuant. In the other two types of transactions this is not the case, the court declined to rule on undervalued and fraudulent transaction and asked RP to pleas the material facts to seek the remedy under Sections 45 and 66 of IBC.

In the case of ***GVR Consulting (Supra),*** the Apex Court of India differentiated the Anuj Jain case based on its facts and held that the "*composite application of PUFE transaction can be made to the Adjudicating Authority and if they are generally filed under separate heads and are substantiated with the specific evidence."*

In the case of ***Star India Private Limited v. Advance Multisystem Broadband Communications Limited,***[26] the NCLT said that need for pleading material facts as upheld in the Anuj Jain case. The tribunal rejected the composite application filed by the RP since specific material facts for Sections 45, 46, 47 and 66 of IBC were not pleaded for and it can be said that the composite application for avoidance transaction can be filed if the allegations and averments are separately made under different heads.

Avoidance Transactions in Companies Act

The Companies Act enacted in the year 2013 also gives us certain provisions which helps in the governing of the transactions made by the companies. Under Section 206 of the Companies Act, 2013[27], the Registrar which scrutinizing the documents has the power to call for further information or explanation if he deems is required and is necessary may issue a written notice and the require the company to furnish the same in writing and make such information or

[26] C.P. (IB) No. 1510/KB/2018 – NCLT Kolkata
[27] The Companies Act, 2013 c.206

explanation as called for or required by the Registrar and can produce such documents if required within a reasonable time period or as specified in the notice issues by the Registrar. When such notice is received by the company then it is the duty of the company and its officers for instance the directors to furnish all the information required within the period specified by the Registrar in the notice.

If for any reason, the information is not produced to the Registrar within the specified period or if the Registrar on examining such documents finds nothing or if on scrutinising the documents the information is found unsatisfactory and no disclosure of full and fair statement of information is made then the Registrar can in another notice call for the company to produce for further books of account, books, papers, and explanations as may be required by him.

If the information provided to the Registrar is satisfied on the basis of information available with or furnished to him or on representation made to him that the business has any fraudulent or unlawful transactions made and are in compliance with the laws under which a company is established or if the grievances put forth by the investors are not addressed by the company then the Registrar has the authority to inform the company of the allegations made against them and call the company to furnish in writing informations or explanation on matters which is specific to the order within the period specified by him or if he deems fit after providing an opportunity to the company of being heard.

The Central Government also in certain cases have the authority to inspect the books and papers of a company by appointing an inspector for this purpose.[28] The Government can by a special order authorise any statutory authority to carry out inspection of books of account of a company or for a class of company. If a company fails in furnishing the information asked by the inspector who is appointed by the Central Government, then the company and its officers can be held liable and be held punishable with fine extending to one lakh rupees and in case of continuing failure add fines as well which can extend up to Five Hundred Rupees for each day until such failure continues.

Section 210 of the Companies Act, 2013 gives the Central Government certain powers to investigation the affairs of the company. The Central Government can if it deems it necessary

[28] Dhoke. S.M. Deshmukh, R. Sethi. S. B, Prabhu S. Bahri, A.Sagar, Manager-Financial Management in Modern Business, Vol. 59, T.B.J.A.M, 158-184 (2023).

investigate the affairs of the company if a receipt of the report of a Registrar or inspector is made or if an intimation of a special resolution and is passed by the company and if it is in public interest can order for investigation.[29] The NCLT can also pass orders in relation to any proceedings before affairs of the company can be investigated and the Central Government can order for investigation into the affairs of the company. The Act can also establish an SFIO or a Serious Fraud Investigation Office which investigates the frauds relating to the company and is established by the Central Government if deemed necessary.

In United States, the fraudulent activities of companies are dealt with the help of a combination of federal and state laws and enforcement agencies and through various avenues related to the reporting and investigation of such fraudulent activity.[30] The Federal Trade Commission (FTC), the Federal Bureau of Investigation (FBI), and the state Attorney General play a vital role in investing and prosecuting the fraud cases. The FTC takes out reports about the scammers that cheat people and of businesses that do not make good on their promises.

In United Kingdom, the fraud activities of a company are dealt by a legislation established in the year 2006 which is the Fraud Act which establishes authorities like the Action Fraud which is the UK's national fraud and cybercrime reporting centre and the Financial Conduct Authority (FCA) which reports all financial crimes.

In Singapore, the fraud activities of a company are regulated or investigated through various combinations of legal frameworks, regulatory bodies, and enforcement mechanisms.[31] The agencies which deal with such activities are the Commercial Affairs Department or the CAD, the Monetary Authority of Singapore, or the MAS and the Accounting and Corporate Regulatory Authority, also known as the ACRA. These specialised departments focus on areas of commercial fraud and financial fraud and the MAS conducts investigations and audits just to ensure that they comply with the provisions established and the regulations enacted by the government.

[29] Gosh P. K, Evolution of Insolvency and Bankruptcy Code, 2016, based on Judicial Pronouncement, Vol.50, CHART.ACCNT, 1539-1543 (2018)
[30] Paradhasardhi. S. Sunil, A and Kulkarni.MD, IBC:Ease of Doing Business-A Review, Vol.13 Issue-02, No.1, D.R.S.R.H, 222-234 (2023)
[31] Michelle J White, Bankruptcy: Past Puzzles, Recent Reforms, and the Mortgage Crisis, Volume 11, Issue 01, AM.L. ECON. Rev, 1-23 (2009)

Conclusion

The avoidance transaction plays an important role in the maximisation of the assets of the Corporate Debtor and helps in protecting the interest of the investors.[32] It helps in creating trust and confidence in all the investors while making investments in the jurisdiction and helps in attracting investment from across the world.

The jurisprudence involving the avoidance transactions which includes preferential, undervalued, fraudulent, and extortionate credit transactions has been shaped by various landmark judgements across different courts of the country like the case of ***Anuj Jain*** clarified essential elements like it clarified the meaning of "ordinary course of business" and irrelevance of intention in determining such kinds of transactions.[33] The Courts also have emphasised on the procedural responsibilities of the resolution professionals.

Professionals involved in the insolvency procedures should have a clear knowledge and understanding about the intricacies carried in such kinds of transactions and should also be thorough with the legal rules and regulations present in the legislation. As legal field continues to evolve, remaining essential factors must also be known as practitioners, stakeholders, and policymakers involved in corporate insolvency and bankruptcy.[34] Judicial review is the main reason for the failure of the insolvency regime and unless the NCLT is sensitive to the effect of such delays and delas with languishing Avoidance Applications, the beneficiaries of such fraudulent transactions will continue to enjoy the result of such transactions.

The avoidance applications are not statutorily bound by time and it is the resolution process and courts do not prioritise them.[35] The situation was resolved after the enactment of IBC and the provision in the resolution plan covering the fate of such provisions.

[32] Sengupta & Sharma, Corporate Insolvency Resolution in India: Lessons from a Cross-Country Comparison, INTL. FIN. ECON, Vol.51, No.15, 37-46 (2016)
[33] Gujatrat Urja Vikas Nigam Ltd. v. Amit Gupta (2021) 7 SCC 209
[34] Randolph. T, Insolvency Moral Hazard, and Expense Preference Behaviour; Evidence from US Savings and Loan Associations, Vol. 39. No.08, MANAG. DECIS. ECON, 600-617 (2018)
[35] Sudheer Chava, Robert A. Jarrow, Bankruptcy Prediction with Industry Effects, Volume 08, Issue 04, REV.FIN, 2004, 537-569 (2004)