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Abatement of Avoidance Applications on approval of Resolution Plans – An avertable anomaly?

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Understanding Avoidance Applications

The last five and a half years since the introduction of the Insolvency and Bankruptcy Code, 2016 (**Code**) have witnessed a sustained effort by all the stakeholders in settling and ironing out some of the key issues relating to reorganization and insolvency resolution of corporate persons, partnership firms, and individuals in a time-bound manner, to ensure maximization of the value of assets of such persons.

In this regard, one of the most critical aspects for maximization of value of a corporate person is to ensure avoidance and reversal of transactions which are either preferential, undervalued, fraudulent or extortionate in nature. The basic purpose of identifying and red flagging such transactions is to ensure that whatever value has been lost due to such transactions, is made good, and recovered for the benefit of the Corporate Debtor.

Sections 43, 45, 50, and 66 of the Code provide for the reversal/avoidance of these transactions undertaken by the Corporate Debtor and/or its management during a certain period immediately preceding the commencement of the Corporate Insolvency Resolution Process (**CIRP**) or during the CIRP. The above provisions read with Regulation 35A of the Regulations create an obligation on the Resolution Professional to form an opinion and determine if the Corporate Debtor has been subject to any such avoidable or reversible transaction(s) and is accordingly required to file an application seeking avoidance and/or reversal of such transactions.

Who can be a beneficiary of Avoidance Applications?

Over the course of the past few years, it has been well settled that the beneficiary of an Avoidance Application will be the Corporate Debtor, and, in turn, its creditors. In other words, a Resolution Applicant, through new management, cannot claim benefit of the recoveries made from such Avoidance Applications. In the intervening period, several Resolution Plans provided for the proceeds of such Avoidance Applications to enure to the benefit of the new Resolution Applicant.

This above position on the beneficiaries of such an application was settled by the Delhi High Court in the matter titled *Venus Recruiters Pvt Ltd v. Union of India & Ors*[1] (**Venus Recruiters Judgment**), wherein the Court held that unless provided in a Resolution Plan, an Avoidance Application will normally abate on the approval of a Resolution Plan.

This innocuous observation has stirred up a hornet's nest. The question which this note seeks to raise and answer, and the question, which, unfortunately the Delhi High Court fell short of answering, is that if a Resolution Plan does in fact permit continuation of an Avoidance Application, will the NCLT have the jurisdiction to decide such application, and if yes, who will be entitled to pursue this application?

Can the Avoidance Application continue after the Approval of a Resolution Pan?

Before answering this question, it is pertinent to analyze Section 26 of the Code which provides that the CIRP of a Corporate Debtor shall remain unaffected while an Avoidance Application remains pending adjudication. The Delhi High Court in the Venus Recruiters Judgment seems to have taken a view and limited the scope of Section 26 by stating that the process of collecting information, forming an opinion, determining an Avoidance Transaction, and filing an Application against the same is '*independent of various other steps which are part of the CIRP*' and the same cannot be interpreted in a manner to say that the applications filed for the avoidance of transactions under Section 25(2)(j) can survive the CIRP itself.

However, an in-depth reading of Section 26 with Section 31 of the Code as well as Regulation 39(4) read with Form-H of the Schedule of the IBBI (Insolvency Resolution Process of Corporate Person) Regulations, 2016 (**CIRP Regulations**), gives us an understanding that the independent nature of Section 26 is not only limited to the initial process of filing an Avoidance Application or till the Plan is approved, but should ideally continue till an Avoidance Application is taken to its logical conclusion.

[1] 2020 SCC OnLine Del 1479

In our view, two essential facts make the Venus Recruiters judgment distinguishable. Firstly, in that case, the Avoidance Application was filed by the Resolution Professional 'after' the Plan was approved and since the office of a Resolution Professional becomes functus officio upon the approval of the Plan, such Resolution Professional was not competent to file an Avoidance Application. Secondly, as per the Resolution Plan in the said case, the proceeds of the Avoidance Application were to go to the Successful Resolution Application as opposed to the creditors.

Interestingly, the interpretation of the Venus Recruiters Judgment fell for consideration before the NCLAT in the judgment titled *63 Moons Technologies Limited Formerly Known as Financial Technologies (India) Ltd v. The Administrator of Dewan Housing Finance Corporation Ltd & Ors*[2] (**63 Moons Judgment**) wherein it was held that it was not for the Committee of Creditors (**CoC**) to decide the beneficiaries of an Avoidance Application, and such decision is to be taken by the Adjudicating Authority.

Neither of these two judgments prevent the continuation of an Avoidance Application, especially if such a clause is expressly mentioned in the Resolution Plan.

A reading of some of the statutory provisions vindicates the above position. Regulation 39(2) of the CIRP Regulations provides that details of avoidable/reversible transactions are required to be placed before the CoC along with compliant Resolution Plans and with orders on such Avoidance Applications, if any. Therefore, the IBBI was conscious that orders on a Resolution Plan may not necessarily be passed before approval of a Resolution Plan.

Under Section 54N(1)(ii) introduced in Chapter III-A of the Code in 2021 regarding Pre-Packaged Insolvency Resolution Process, the Adjudicating Authority was also entrusted with providing for the manner of continuation of avoidance of preferential, undervalued, extortionate and fraudulent transactions. This can be read as the intention of the legislature permitting the continuation of Avoidance Applications even after the insolvency resolution process has been terminated. On the contrary, it could very well be argued that while under the pre-pack process, the legislature permitted continuation of Avoidance Applications, it has consciously chosen not to introduce similar provisions in the usual CIRP.

In our view , nothing in the Code prevents continuation of such applications after approval of the Resolution Plan so long as the following two criteria are met. First, that the approved Resolution Plan must provide for continuation of such proceedings, and second, that the proceeds of such Avoidance Applications must necessarily enure to the benefit of the creditors of the Corporate Debtor.

In addition to be being legally justifiable, proceeding on the basis of our interpretation would go a long way in mitigating the unfortunate scenario across various NCLTs in the country, where various Resolution Plans are awaiting approval on the erroneous interpretation that an Avoidance Application must be decided before approving a Resolution Plan.

Who can pursue these applications?

The Venus Recruiters judgment unequivocally holds that the ultimate beneficiary of an Avoidance Application must be the creditors of the Corporate Debtor.

Having said that, on approval of a Resolution Plan, the moratorium is lifted, and the Resolution Professional becomes *Functus Officio*. The provisions pertaining to filing of Avoidance Applications mention that they must necessarily be filed by the Resolution Professional. The only exception to this is undervalued transactions, which, under Section 47 can also be reported by a creditor or a member of the Corporate Debtor.

Since the original *Dominus Litus* of the Avoidance Applications becomes *Functus Officio*, we believe that it can only be the beneficiaries who should be permitted to continue to pursue and prosecute the Avoidance Applications. A beneficiary of an application will do maximum justice to diligently pursue and take an Avoidance Application to its logical conclusion.

Clarificatory amendments in the pipeline?

On April 13, 2022, the IBBI came out with a consultation paper on issues relating to delays in the corporate insolvency resolution process, and invited comments from the general public, inter alia, on certain proposed amendments regarding the pursuing of Avoidance Applications. The proposed amendments, which make it mandatory for a resolution plan to provide the manner in which proceedings for Avoidance Applications are to be pursued after the approval of a resolution plan, vindicate our conclusion regarding the position of the law and the intention of the legislature apropos continuation of Avoidance Applications even after the approval of resolution plans.

Conclusion

To sum up, on a conspectus of the above law and facts, our three-fold conclusion is as under:

- If permitted in a Resolution Plan, an Avoidance Application must continue to be decided even after approval of the Resolution Plan – therefore meaning that an Avoidance Application need not be decided prior to deciding an application for the approval of a Resolution Plan.
- The beneficiary of an Avoidance Application must necessarily be the creditors of a Corporate Debtor.
- The creditors of the Corporate Debtor must be permitted to pursue the Avoidance Applications after the approval of a Resolution Plan.

We sincerely hope that the NCLTs, the NCLAT and the Supreme Court (and not to mention, the Delhi High Court, where the challenge to the *Venus Recruiters Judgment*[3] is pending) take a similar view, which will be for the ultimate benefit of all concerned.

[2] Judgment dated 27th January 2022 passed in Company Appeals (AT) (Insolvency) No. 454, 455 and 750 of 2021

[3] Tata Steel BSL Ltd. vs. Venus Recruiter Pvt Ltd. & Ors Bearing LPA No. 37 of 2021 and in Union of India vs Venus Recruiter Pvt Ltd. & Ors bearing LPA No. 43 of 2021