Ms. Bhargavi Kannan is an advocate practicing at the Supreme Court & the High Court of Delhi

Avoidance Applications cannot Languish Indefinitely, Rules the Delhi High Court

The Delhi High Court has provided much needed clarity on the fate of pending avoidance applications under Section 43 of the Insolvency and Bankruptcy Code, 2016 (IBC), after conclusion of the corporate insolvency resolution process (CIRP).

In her judgment dated November 26, 2020 in ***M/s. Venus Recruiters v. Union of India & Ors.(2020) ibclaw.in 41 HC***, Justice Pratibha Singh decisively ruled that avoidance applications that are pending as on the date of approval of the resolution plan, cannot be permitted to continue after the approval of the resolution plan under Section 31 of the IBC.

The decision was rendered in a writ petition filed by one M/s. Venus Recruiters, a manpower contractor of the erstwhile Bhushan Steel Limited. Bhushan Steel was one of the big twelves, that underwent a rather long drawn and contentious insolvency process, which was resolved by Tata Steel Limited (Tata Steel) in 2018.

In this case, the Resolution Professional (RP) of Bhushan Steel filed an application before NCLT Delhi on April 9, 2018, seeking avoidance of certain allegedly preferential transactions, including Bhushan Steel's contract with Venus Recruiters. The application came to be filed after Tata Steel's plan was approved by the Committee of Creditors (CoC) on March 20, 2018 and while it was pending for approval before the NCLT (the application for approval was filed on March 28, 2018).

Almost five weeks after the filing of the avoidance application, on May 15, 2018, the NCLT approved Tata Steel's resolution plan and simply disposed of all other applications. Soon thereafter, the new management of Bhushan Steel took over.

On July 24, 2018 however, the NCLT issued notice on the avoidance application. On August 25, 2018 (after the NCLAT upheld the NCLT plan approval order), the NCLT impleaded Venus Recruiters as a party to the RP's avoidance application and issued fresh notice. Aggrieved by this, Venus Recruiters petitioned the Delhi High Court, praying for the proceedings against it in the NCLT to be quashed.

Venus Recruiters argued that an avoidance application cannot survive the conclusion of CIRP since (a) the RP became *functus officio;* and (b) the jurisdiction of the NCLT could not extend beyond the CIRP completion date. It was also contended that the timelines provided in the IBBI (Corporate Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (CIRP Regulations) envisaged the completion of avoidance proceedings before the resolution plan was approved. The thrust of the argument was that proceeds from avoided transactions should inure to the benefit of the creditors and therefore, this should essentially be factored into the plan itself. Working backwards, avoidance applications necessarily have to be determined before CIRP completion.

The Respondents, including Union of India and Tata Steel argued that avoidance transactions have to be treated differently. Relying on Section 26 of the IBC, which provides that avoidance applications by the RP "*shall not affect the proceedings of the corporate insolvency resolution process*", the Respondents contended that such applications could be prosecuted even after the CIRP. The reason for de-linking avoidance applications from the rest, was because adjudication of avoidance transactions could take much longer than the timelines fixed in the IBC for conclusion of CIRP. The Respondents also relied on the Third Report of the Insolvency Law Committee dated February 20, 2020 (ILC Report), which suggested that an avoidance application may continue even beyond the CIRP, based on an interpretation of Section 26 of the IBC.

Justice Singh, however, was not convinced with the arguments advanced by the Respondents. The Court ruled that:

- An avoidance application is meant to benefit the creditors of the corporate debtor (in its state prior to the insolvency) and not the corporate debtor in its 'new avatar', after approval of the resolution plan. This is evident from Section 44 of the IBC, which sets out the kind of orders which the NCLT can pass in such cases. Clearly, the benefit of such orders would be for the corporate debtor, prior to the approval of the resolution plan.
- Any property, money or benefit acquired by an avoidance order, would have to form part of the final resolution plan, as it inures to the creditors. No benefit would come to the creditors after the plan is approved.
- A conjoint analysis of Sections 43 and 44 read with the CIRP Regulations clearly shows that the assessment by the RP of preferential transactions cannot be an unending process.
- The RP becomes *functus officio* after the approval of the resolution plan and cannot file or prosecute any applications thereafter, including those under Section 43. The RP cannot continue to act on behalf of the corporate debtor, under the title of *'Former RP'*.
- Even Section 26 cannot be read in a manner so as to mean that an avoidance application can

survive after the CIRP process.

- The ILC Report also suggests that a successful resolution applicant cannot be permitted to file avoidance applications, as the same was not factored into their bid.
- If an avoidance application is permitted to be adjudicated beyond the CIRP, in effect, the NCLT would be stepping into the shoes of the new management to decide what is good or bad for the company.
- The parties would have to be therefore left to their civil and other remedies in terms of the contract between them.

This is a crucial judgment that clears the air around the fate of avoidance transactions. With many of the initial insolvencies reaching the post approval stage now, NCLTs across the country may draw guidance from this case to deal with languishing avoidance applications.

More importantly though, this judgment sends a strong message to the NCLTs - to prioritize disposal of avoidance applications. It is quite common for these seemingly complicated and fact intensive applications to take the backseat as the CIRP progresses. What this decision effectively does, is to stipulate a deadline for the adjudication of such applications – a deadline that is not statutorily prescribed, either in the IBC or the CIRP Regulations. Perhaps we may see this judgment finding its way into the next tranche of amendments to the IBC, if it is not overturned by the Supreme Court.