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AVOIDANCE APPLICATIONS CAN CONTINUE BEFORE NCLT POST PLAN APPROVAL – CLARIFIES DELHI HIGH COURT IN TATA STEEL BSL VS VENUS RECRUITERS (2023/DHC/000257)

27 January 2023

Brief Facts

- On 26 July 2017, the National Company Law Tribunal New Delhi (NCLT) passed an order admitting M/s Bhushan Steel Limited (Corporate Debtor) into corporate insolvency resolution process (CIRP), pursuant to a Section 7 application filed by the State Bank of India (SBI) under the Insolvency and Bankruptcy Code, 2016 (Code). Tata Steel Limited (TSL) emerged as the successful resolution applicant with its proposed resolution plan being approved by the Committee of Creditors (CoC) of the Corporate Debtor on 20 March 2018. Subsequently on 28 March 2018, the resolution professional (RP) filed an application for approval of the proposed resolution plan by TSL (Approval Application) before the NCLT in terms of Section 31 of the Code.

- During the period of pendency of the Approval Application, the RP discovered several suspect transactions entered into by the Corporate Debtor with related parties, including a preferential transaction undertaken by the Corporate Debtor with Venus Recruiters Private Limited. (Venus/Respondent). Consequently, prior to the final approval of the resolution plan, the RP had filed an application before the NCLT under Sections 25(2)(j), 43 to 51 and 66 of the Code (Avoidance Application), wherein various transactions were enumerated as "suspect transactions" with related parties.

- In the interim, on 15 May 2018, the resolution plan was approved by the NCLT, which was upheld by the National Company Law Appellate Tribunal (NCLAT) on 10 August 2018. On 18 May 2018 the resolution plan was implemented in finality and the new management, being Tata Steel BSL Limited (Tata Steel BSL) assumed control of the Corporate Debtor. Meanwhile, pursuant to the Avoidance Application, the NCLT proceeded to issue notice (Notice Order) to the Respondent company.

Proceedings before the Single Judge

- Aggrieved by Notice Order in the Avoidance Application, Venus filed a writ petition (W.P.(C) No. 8705 of 2019) (Writ Petition) before a single judge (Single Judge) of the Hon'ble Delhi High Court, contending that the proceedings borne out of the Avoidance Application were rendered void and *non-est* since CIRP had concluded and the management of the Corporate Debtor had been taken over

by Tata Steel BSL. The single judge of the Hon'ble Delhi High Court *vide* its judgement dated 26 November 2022 (Impugned Judgment) *inter alia* held that an application filed under Section 43 of the Code for avoidance of preferential transactions cannot survive beyond the conclusion of the CIRP and any order with respect to avoidance transactions must be passed prior to the approval of the resolution plan. The Single Judge also held the Writ Petition to be maintainable on the ground that the NCLT does not have jurisdiction to delve into issues apart from those related to resolution plans, after an approval order has been passed.

- The Impugned Judgement was appealed by Tata Steel BSL, and Union of India before the Division Bench of the Hon'ble High Court of Delhi (Division Bench) *vide* Letters of Patent Appeals, being LPA No. 37 & 43 of 2021.

Observation of the Division Bench

Maintainability - At the outset, it was observed that NCLT has the power to adjudicate on all matters 'arising out of' and 'in relation to' insolvency resolution. The terms 'arising out of' and 'in relation to' were interpreted broadly by the Division Bench to include even avoidance applications, notwithstanding that a resolution plan may already have been approved. Considering that NCLAT would be the appropriate forum to entertain an appeal against the Notice Order, the Division Bench found that the single judge erred in entertaining the Writ Petition. Notwithstanding that the Writ Petition was found non-maintainable, the Division Bench proceeded to give its findings on the legal issues raised in the petition.

Filing of avoidance applications - The division bench noted that the timelines mentioned under Regulation 35A Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (CIRP Regulations) for filing of an avoidance application by the RP are directory and not mandatory. The bench further noticed the practical difficulties that an RP may face in collating information and forming an opinion for filing of avoidance applications within the specified timelines. There is no penalty clause under the Code against the RP for failure to file the avoidance application within the prescribed timelines, and further there is no time limit given for adjudication on these applications by NCLT. The duty cast on the RP under the Code is to file the avoidance application before conclusion of CIRP. The interpretation adopted by the single judge in the Impugned Judgment was thus set aside on the ground that such interpretation would lead to the beneficiaries of suspect transactions go scot-free, thereby rendering the provisions of the Code otiose.

Continuation of avoidance applications by the RP after plan approval - The Division Bench observed that the nature of avoidance proceedings is such that they are likely to last beyond conclusion of CIRP as they require investigation and discovery of suspect transactions. This is consistent with the provisions of Sections 25 and 26 of the Code, Regulation 38(2)(d) of the CIRP Regulations, the observations made in the 'Insolvency Law Committee' (ILC) report dated 20 February 2020, and ILC report of May 2022. The Division Bench clarified that the avoidance applications and CIRP are distinct and independent proceedings, and the office of the RP does not become *functus officio* on the conclusion of the CIRP and can continue to pursue the avoidance applications. The method and manner for the RP to pursue the same was left for the determination of the NCLT.

Appropriation of amounts from Avoidance Applications - Regulation 38(2)(d) of the CIRP Regulations that have been introduced with effect from 14 May 2022 were noted by the bench. These regulations mandatorily require resolution plans submitted after 14 May 2022 to provide for the manner in which avoidance applications would be pursued after approval of the plan and the manner in which the amounts recovered from such avoided transactions would be appropriated. The bench noted that the

amounts received from avoided transactions were not accounted for by TSL while submission of its resolution plan in view of delayed filing of application by the RP. The bench held that TSL cannot be the beneficiary of the amounts so received and the benefits are to be appropriated to the creditors. It was held that cases where treatment of benefit acquired from avoidance transactions could not be accounted for in resolution plans, such benefit would accrue to the creditors.

Comments / Key-Takeaways:

The long-drawn dilemma regarding continuation of avoidance proceedings after approval of resolution plan has been put to rest by the present judgment.

- The judgment clarifies the position of law that the proceedings for avoidance transactions under Section 43-66 of the Code are independent of the CIRP and shall survive its conclusion.

- It further clarifies that a resolution professional does not become *functus officio* with respect to adjudication of avoidance applications and can continue to pursue the same post CIRP conclusion. This has commercial implications since CIRP Regulations (as amended by the fourth amendment) (CIRP (Fourth Amendment) Regulations) have provided that a resolution plan must provide for treatment for avoidance proceedings and proceeds (if any) emanating therefrom, post the approval of the resolution plan.

- The judgement also clarifies the position for resolution plans approved prior to the introduction of the CIRP (Fourth Amendment) Regulations and holds that in the event a resolution plan does not provide for treatment of an avoidance application, any proceeds recovered from its adjudication shall be appropriated to the creditors of the erstwhile corporate debtor.

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