

Insolvency and Bankruptcy Law in India

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Week 10

Lecture 46

Hi, welcome to Session 46, where we'll be discussing undervalued transactions. As explained before, there are four types of avoidance transactions.

Today, we will discuss the second type of avoidance transaction, which is the undervalued transaction. But before that, a quick recap of the previous session, where we talked about preferential transactions: Section 43 speaks about preferential transactions and makes a reference to an antecedent transaction, based on which a preferential transaction is entered. There, we discuss when a transaction is presumed to be preferential, and the burden of proof lies with the party that has entered into a preferential transaction. This is what we have done under Section 43. After that, we have seen under Section 44 that the adjudicatory authority, upon an application made by either the liquidator or the resolution professional, will pass an order. There are seven or eight types of orders that it can pass. After that, we have seen, with the help of case law, how these preferential transactions are analyzed, understood, and treated under the IBC at the time of liquidation or CIRP. This is a recap.

Let's quickly move on to the current session, where we'll discuss undervalued transactions. Section 45 of the IBC discusses undervalued transactions. Please remember the sequence: 43 is a preferential transaction, 44 is orders, and 45 is undervalued transactions. And accordingly, it covers transactions entered into during the relevant period that are considered undervalued. So, what are the types of undervalued transactions? Firstly, if during a certain period preceding the commencement of the CIRP, certain transactions were entered into by the CDE, as listed in the green and orange boxes, then these transactions can be considered undervalued transactions and treated as avoidable transactions, correct? What are the two types of undervalued transactions that occurred during the relevant period? Number one: Has the corporate debtor given any gift to any person? Remember, a very interesting point: why are companies floated by any person? Companies are floated with the objective of generating profits, and those profits are distributed to the shareholders who have invested their money.

Now, the question is, can a corporate debtor, like an individual member, actually gift property to any third party? The moment you are gifting, it is understood that there is some kind of inherent malafide intention, which is obvious, you know, so. If a gift is made during the relevant period preceding the commencement of the CIRP or liquidation, then such a transaction may be considered an undervalued transaction, and how to address it will be addressed eventually. Part 2. If the company transfers an asset for consideration that is significantly lower than what the corporate debtor paid for that asset, then such a transaction can be considered an undervalued transaction.

Let's simply understand what I mean. Let's say I bought land for maybe five crores in 2005 in a certain place. After 15 years, possibly in 2021 or 2022, when the CIRP was about to begin, I transferred this land to a party at a price of 1 crore. This is an unbelievably undervalued transaction. Why? If you bought a property in 2004 or 2005 for ₹ 5 crores, it should naturally be valued at ₹ 30 to ₹ 40 crores today. That's how real estate has boomed in India. However, if you now truly value it at 1 crore and sell it to a party, this would be an undervalued transaction. However, please note that this depends on the type of asset. If I had bought a Rolls-Royce car in 2005, a certain model would have cost me 5 crores. At the end of 20 years, in 2023-2024, what value can I sell this car for? Obviously, you will sell this car at a significantly lower value, something like 50 to 60 lakhs. That is not an undervalued transaction because the asset has actually depreciated in value.

Remember that we are talking about those assets whose value either appreciates or at least remains intact. However, assets that are depreciating have a market value that is phenomenally lower; in such cases, we don't call them undervalued transactions. This is purely common sense. So, let's move forward. Such a transaction, if it is not in the ordinary course of business, whether the gift or the sale of an asset is not in the ordinary course of business, might, in all probability, fall under undervalued transactions and hence can be avoided. What is the relevant period during which this transaction can be considered undervalued? Let's understand this. I did a transaction about 10 years ago at a lower value. CIRP is commencing 10 years later. This transaction, which occurred 10 years ago, will have no impact on CIRP today. Hence, such transactions cannot be avoided. That's why, within the timeframe before the commencement of insolvency or liquidation, the time at which the transaction took place, and whether it falls within the relevant time mentioned in the section, determines whether it's an avoidable transaction.

So, let's see what the time is. If this transaction involves the gift or transfer of property at a lesser value to a related party, it means the related party would include a relative of a director, a relative of a promoter, an employee of the company, or a holding company or subsidiary company. If you are doing this transaction, the time period is that I can go back two years from the date of insolvency and still classify it as an avoidable transaction. However, if the same is not a related party transaction, as specified in the

second part of the table, second row, then the timeframe I can look back is only one year. Right. So, for related party transactions, I can go back two years and check whether it is an avoidance transaction. But for a non-related party, I only have one year to go back and check whether it's an avoidance transaction. This is good for the corporate debtor. The more time you have, the more transactions can unnecessarily create trouble. Therefore, we have taken a relevant period of only two years for related parties and one year for unrelated parties.

The adjudicating authority may require an independent expert to assess evidence related to the value of the transactions. Most of the time, for a common man or for a jurist, even an adjudicatory authority, judicial member, or technical member, it might be very, very difficult to determine whether a transaction is undervalued or not. For example, if I have a patent right or if I have a registered patent in my name, which was made in 2020 for a certain value, and I'm going to sell it now at a certain value, whether that patent right will be sold at a lesser or greater value is something that is impossible for me or for a judge to determine. Hence, this should be presented to someone who's an expert in valuing intangible assets, and only that person can determine whether it is undervalued or overvalued.

Hence, the section itself provides that, in case of doubt, adjudicating authorities can seek the opinion of an expert to determine whether the transaction is undervalued or not. If I, as a liquidator, corporate officer, or resolution professional, have decided that a transaction is actually undervalued, what should I do? Or, if the creditor has realized that there is an undervalued transaction that is not recognized by the resolution professional or liquidator, these are the circumstances, right? The first circumstance where the liquidator RP has already determined that it is an undervalued transaction is that he will make an application to the NCLT; we are aware of this, and the NCLT will decide it as an avoidable transaction. However, if it escapes the attention of a liquidator or a resolution professional, then perhaps a creditor will realize for themselves that there is an undervalued transaction; can you make an application to the NCLT? Absolutely, yes. Section 47 of the IBC provides that the creditor can make an application to the NCLT. If an undervalued transaction has occurred and the liquidator or resolution professional has not reported it to the NCLT, a creditor, member, or partner of the corporate debtor can apply to the NCLT to have the transaction declared void and to reverse its effects.

Now, apart from the consequences of such a transaction, or setting aside that transaction, there is also one more important aspect that you should observe: if there was an avoidable transaction pointed out by the creditor, what was the IRP or liquidator doing? Why didn't they point out that, you know, there is a certain avoidance transaction that has occurred? Hence, if the adjudicatory authority fails to determine that the resolution professional or liquidator is at fault and that disciplinary action should be taken against them, then the NCLT will ask the board or the insolvency professional agency to investigate the actual

disciplinary aspects of the liquidation professional. Let's read the paragraph. The NCLT has the authority to initiate disciplinary action against the resolution professional or liquidator if it is found that an undervalued transaction took place and the RP or liquidator failed to report such transactions to the adjudicatory authority.

Then, whoever makes an application, whether it is the applicant, a resolution professional, or the creditor, the effects of such an application will be dealt with in Section 48 of the Act, where orders can be passed for undervalued transactions. We are now trying to understand the types of orders that can be passed by the adjudicating authority under Section 48 when an avoidance transaction is reported to the NCLT. First, the property that is dealt with as an undervalued transaction and transferred to a third party will now be reacquired by the CD. This is a primary order. That is, now the property will vest in the CD itself. Two, if there is any security interest in the properties of the CD created, then the adjudicating authority can say that this particular security interest is discharged. Hence, there is no longer a security interest in the property of the corporate debtor. Then, the third order requires any person to pay certain sums in respect of benefits received by them. I told you an example where properties worth 25 crores were transferred to a person for 5 crores. That's an undervalued transaction. The NCLT may now ask that person to return the 20 crores that they received as a benefit due to the undervalued transaction. Then the last one requires payment of such consideration by any party that has not paid.

So, we have seen three sections: 46, 47, and 48. In 46, we have seen that the resolution professional or liquidator will make an application in the event of an undervalued transaction. In 47, the application will be made by the creditor. And in 48, what kind of orders can be passed by NCLT or the adjudicating authority? What kind of transactions can be considered undervalued? We are looking at the examples. Mr. Preetam Tadani is the founder and director of Tadani Cements Limited. The company borrowed a loan of 1,500 crores from NoBank Limited and is on the verge of default. Realizing the potential threat of insolvency and the consequential CIRP, the company sold one of its plants, along with a substantial land bank worth 1,200 crores, to Mr. Rakesh Hiramal, the brother-in-law of Mr. Tadani, for a meager sum of 300 crores. See, before even understanding the provisions, when we apply our common sense and legal sense to the context, we easily know what is going to happen, right? Therefore, a property worth 1200 crore is transferred to a certain person for 300 crore. For what reason? The reason is simple. If the CIRP commences, this property will be removed from the corporate debtor's control, sold, and distributed to the creditors. Therefore, this property must now be safeguarded by the promoters for their own personal interests. How would they do that? They would simply transfer the property to one of their relatives. Later on, they can all enjoy the benefits of the property.

But how? The guy cannot pay the market value of the property. Therefore, we offer a phenomenal discount and transfer the property at a substantially lower rate to a relative. Later on, we can sell this in the open market at market value and reap the benefits ourselves. So, if you see, the market value is 1200 crore, and the sale price is 300 crore. We saved about 900 crores, which we can all enjoy later. This is what I call criminal intelligence, which, you know, the lawyers and advocates must get accustomed to. We must start thinking like the CD promoters and creditors will at a certain point: what kind of mischief they might play to protect their interests, and how we should circumvent the scenario to bring real justice to all parties involved. As you can see, they've made an undervalued transaction for the benefit of the CD and its promoters.

Now what happens? Let's say that at this stage, the CD goes into CIRP. In the next six months, the RP's first step will be to identify this transaction and declare it an avoidable transaction. RP then files an application to NCLT and seeks avoidance of this transaction. If NCLT finds substantial evidence, it may call this an undervalued transaction and actually cancel the transaction to benefit the CD. There is a practical case law example that actually occurred regarding an undervalued transaction, and how the NCLT decided on the matter. This case was brought by the directors of Adriatic Seafoods Pvt. Ltd. Remember, Adriatic Seafoods is not the corporate debtor. The directors of this company are suing Suresh Kumar Jain, who is an RP of a certain corporate debtor. Why? We will see that in the facts of the case. This pertains to the legal provisions of sections 45 and 46 of the Act, and the adjudicating authority is none other than the NCLAT, which serves as an appellate tribunal. The principal bench dealt with this case, and the facts are straightforward as follows. CIRP was admitted against Messrs. M.K. Overseas Pvt. Ltd. Now, please mark that M.K. Overseas Pvt. Ltd. is a corporate debtor, which had done certain actions. And hence, Suresh Kumar, the RP, will approach the NCLT to actually set aside certain transactions under the heading avoidance transactions, correct? So, who is the CD? The CD is MK Overseas, not Adriatic Seafoods.

Okay, now, second fact: MK Overseas had several assets, which included a CD, and one of the assets was a plant situated in Panvel, Maharashtra, in an industrial area. The plant and the property were mortgaged to Yes Bank. The company wanted to sell the property and distribute the proceeds. It sought NOC from the bank. That means I'm now unable to repay the loans. Hence, the only option I have is to sell certain properties and continue repaying the loans. So it went to the bank, which is actually a lender and under whose charge the asset is situated. Without the lender's NOC, you cannot actually repay or sell the assets. So, therefore, they asked Yes Bank for permission: "Can I sell the asset?" Yes Bank said, "Fine, please go ahead." But the minimum sale consideration for the transfer of such an asset shall be 17.86 crores. Please look at line 5, point number 5, which is very clearly highlighted. What happened after this discussion with Yes Bank? The property

was actually sold for 63 lakhs, right? Where are 17.86 crores, and where are 63 lakhs? I'll tell you why it was sold for 63 lakhs eventually in the case law.

Then, point number seven states that the RP made an application to the NCLT in New Delhi for the avoidance of this undervalued transaction. NCLT ruled in favor of RP; that's why, remember this is a case with the NCLAT, which means it's an appeal. When RP has already received an order in his favor, he will not make an appeal; hence, the other party against whom the order is obtained is making an appeal in a court of law. Remember, the corporate debtor sold the asset to Adriatic Seafoods Pvt Ltd. The buyer, affected by the NCLT's order, appealed to the NCLAT and requested appropriate relief against the liquidator or the resolution professional, Suresh Kumar Jain. Point number eight: the NCLT ruled in favor of the RP. Now point nine, an appeal is preferred by the buyer with the appellate tribunal against the order of the adjudicating authority.

Let's look at the two sides of the argument. What is the appellant's argument? That the buyer of the property is for an undervalued consideration. The property was purchased through a registered sale deed. There are several prayers pending before the NCLT. The NCLT never heard us. The adjudicating authority passed the impugned order hastily without even hearing us. So, as an appellant, my argument to NCLAT is that NCLT, the adjudicating authority, violated the basic principles of natural justice by not hearing me and passing an impudent order against me. Hence, this appeal is justified in my view. Now, obviously, what is the respondent going to say? The respondent's arguments are very simple. The property's possession was transferred to the buyer in August 2019, just two months before the commencement of the CIRP, which began in October 2019. According to Yes Bank itself, the value of the property is approximately 17.86 crores. Although the actual consideration received is only 63 lakhs, the RP believes that this transfer was made in anticipation of a CIRP and should be considered an undervalued transaction. You recall that for an undervalued transaction, we mentioned two key factors: whether the transaction involves a related party. If it's a related party, I can go back two years; if it's not a related party, I can go back one year.

In this case, the transaction occurred just two months before the commencement of the CIRP; hence, there is a very good likelihood that it will be considered an undervalued transaction. So what did NCLAT do? The same conclusion was reached: the NCLAT stated that the agreed-upon consideration of Rs. 11 crores was to be paid by Adriatic Seafood to the CD, whereas it actually paid only Rs. 63 lakhs. Instead of recovering the balance consideration of approximately 10 crores, the CD actually transferred the entire position to the buyer for a meager consideration of 63 lakhs. This clearly displays the intention of the corporate debtor to sell the asset, indicating that it should be removed from the company's assets so that it is not within the reach of the liquidation or CIRP estate. Hence, the NCLAT dismisses the buyer's appeal, citing that there are no merits in the case.

Therefore, in this case, the RP has established that this is an undervalued transaction. Briefly summarizing what we have discussed so far, we have covered sections 45, 46, 47, and 48. Section 48 talks about how to understand an undervalued transaction. Section 46 provides for a relevant period of two years for a related party and one year for a non-related party. What constitutes avoidable transactions? A gift on one side and the transfer of property for significantly less consideration than what is paid by the corporate debtor can be considered undervalued transactions. Then, under section 47, we read that in case the RP or liquidator is not informing the adjudicatory authority, then the creditor himself can make an application under section 47 and seek appropriate relief, and in all the above cases, an order will be passed by the NCLT under section 48 of the Act. Additionally, we have seen a case where a company purchased the asset for a meager amount of 63 lakhs, despite an estimated value of 17.68 crores. So, friends, these are the kinds of mischief played by corporate debtors at the right time. As resolution professionals and liquidators, they must exercise caution in taking it forward; therefore, they must bring these matters to the attention of adjudicatory authorities for appropriate relief.

This brings us to the end of session 46, and we'll see you in session 47.

Thank you.