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CORPORATE LAWS
Case Law Update

SEBI

Order of Adjudicating Officer of Securities and Exchange Board of India

Name of the Case: In the matter of Coffee Day Enterprises Ltd

Facts of the case

1. Coffee Day Enterprises Ltd, (hereinafter referred to as ***"Noticee"***/"***the Company"***/***"CDEL"***) is the parent company of Coffee Day Group. The Company's equity shares are listed on NSE and BSE since November 02, 2015. The Company does business in multiple sectors such as coffee-retail and exports, leasing of commercial office space, financial services, Integrated Multimodal Logistics, Hospitality and Information Technology (IT)/Information Technology Enabled Services (ITeS), primarily through its subsidiaries, associates and joint venture companies.

2. Mr. V.G. Siddhartha ("**VGS**"), the Chairman of the Coffee Day Group, reportedly committed suicide in the month of July 2019, and in his suicide note, he revealed that he was in huge debt. Post this incident, the Board had engaged the services of Shri Ashok Kumar Malhotra, retired DIG of Central Bureau of Investigation and Agastya Legal LLP to inter-alia investigate the books of accounts of CDEL and its subsidiaries. Further, the SEBI had also initiated an investigation in the matter on its own, to ascertain whether funds were diverted to related entities which resulted in possible violation of provisions of SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003 ("**PFTUP Regulations**") and/or SEBI (Listing Obligations and Disclosure Requirements, Regulations, 2015.

3. The investigation report submitted by Shri Ashok Kumar Malhotra and detailed investigation carried out by SEBI revealed a diversion of funds amounting to Rs. 3,535 Crore from seven (7) subsidiaries of CDEL to Mysore Amalgamated Coffee Estates Ltd. ("***MACEL")***, an entity related to promoters of CDEL.

4. MACEL owned coffee estates and used to supply coffee beans in the ordinary course of business to the subsidiary of CDEL. Hence, there have been regular financial transactions between MACEL and the subsidiaries of CDEL.

There were a lot of transactions on daily basis between MACEL and these entities. Further, SEBI noted that the investigation report stated that VGS transferred the amount from MACEL to various entities himself or by using the cheques pre-signed by Authorised Signatories. VGS used to ask the Authorised Signatories to sign a bunch of cheques which were kept in his possession and used as and when required. Further, it was found that Late VGS had transferred funds Rs. 3,535 crores from subsidiary companies of CDEL to MACEL without seeking approval of the Board, Audit Committee or shareholders, as the case may be and thereby violating the provisions of Regulation 23 (1) & (2) and 24 of the Listing Obligations and Disclosure Requirements, Regulations, 2015 (hereinafter referred to as '***LODR Regulations, 2015***').

5. SEBI then noted that relate/d party transactions of CDEL (on a consolidated level) with MACEL during FY 2018-19 i.e. Rs. 842 Crore, exceeded ten per cent of annual consolidated turnover of CDEL (10% of the turnover of Rs. 3,787 Crore), as per its audited financial statements for FY 2017-18. Similarly, related party transactions of CDEL (on a consolidated level) with MACEL during FY 2019-20 i.e. Rs. 2,693 crores, exceeded ten per cent of the annual consolidated turnover of CDEL (10% of the turnover of Rs. 4,264 Crore), as per its audited financial statements for FY 2018-19. However, no shareholders' approval was obtained by CDEL for the aforesaid related party transactions with MACEL during FY 2018-19 and FY 2019-20, as required under regulation 23(4) read with regulation 23(1) of the LODR, Regulations, 2015. It was also, observed that out of the funds diverted from subsidiaries of CDEL to MACEL, the majority of funds were further diverted from MACEL to entities where VGS and his relatives were interested parties, of which Rs. 3,088 Crore went to VGS himself and Rs. 145 Crore went to Malavika Hegde.

7. Further, the Annual Report of CDEL for FY 2018-19, disclosed only two subsidiaries, viz. Coffee Day Global Limited ("**CDGL**") and SICAL Logistics Ltd as 'material subsidiary'. However, as per the Investigation Report submitted by Shri Ashok Kumar there are 6 subsidiaries that can be identified as the material subsidiary. Coffee Day Trading Ltd ("**CDTL**"), a subsidiary of the Company fulfilled the criteria prescribed under Regulations 16 and 24 of the LODR Regulations, 2015, since the income of CDTL for FY 2018-19 was Rs. 327.26 Crore and for F.Y. 2019-20 was Rs. 971.20 Crore which exceeded 10% of annual consolidated turnover or net worth of CDEL. However, the fact of its being a material subsidiary was not disclosed in the Annual Report of CDEL. Therefore, CDEL had allegedly failed to identify material subsidiaries in accordance with Regulation 16 of LODR Regulations, 2015. Thus, resulted in significant transactions of fund diversion missed out from the scrutiny and notice of the Board of Directors and Audit Committee of CDEL, thereby leading violation of Regulations 16 and 24 of the LODR Regulations, 2015.

7. There was an approximately 88% fall in the price of scrip after the news of the untimely and unfortunate passing away of VGS and his admission to the Board of Directors and Coffee day family of responsibility for every financial transaction between CDEL/its

subsidiaries and MACEL and its related entities came to the knowledge of the public. Apparently, the aforementioned diversion of funds and its concealment amounted to unfair trade practice in the securities market in terms of regulation 4(1) of the PFUTP Regulations, 2003, thereby resulting in violation of provisions of Regulations 3(b), (c) & (d) and Regulation 4(1) of PFUTP Regulations, 2003.

Charge

Violation of the provisions of Regulations 16, 23(1), 23(4) & 24 of the LODR Regulations, 2015 and Section 12A(a), (b) & (c) of the SEBI Act, 1992 read with Regulations 3(b), (c) & (d) and 4(1) of the PFUTP Regulations.

Arguments/submission by Noticee

1. **Failure to identify material subsidiary:** The allegation that CDTL fulfilled the criteria for 'material subsidiary' as its income of Rs. 327.26 Crore for the FY 2018-19 and Rs. 371.20 Crore for the FY 2019-20 exceeded 10% of the annual consolidated turnover or net worth of CDEL but was not disclosed as a material subsidiary in the Annual Report of CDEL is incorrect. Noticee contended that the provisions of Regulations 16(1)(c) of LODR Regulations, 2015 as they existed at the relevant time i.e. during FY 2018-19, provided a threshold limit of 20% of income or net worth of the listed entity in the previous financial year for qualifying a subsidiary as a material subsidiary, as against 10% mentioned by SEBI in the SCN. Noticee further contended that, during the previous financial year, i.e., FY 2017-18, the income of CDTL was Rs. 167 Crore whereas CDEL's consolidated income was Rs. 3,851 Crore, i.e., CDTL's income was 4% of the consolidated income of CDEL. The Noticee has further contended that the provision of Regulation 16(1)(c) was amended to reduce the threshold limit to 10%, with effect from April 01, 2019. Hence according to the Noticee, for the FY 2019-20, even if the revised threshold limit is considered, then also CDTL did not qualify to be a material subsidiary for FY 2019-20, since in the previous financial year, i.e. FY 2018-19, the income of CDTL was Rs. 327 Crore whereas the consolidated income of the Noticee was Rs. 3,741 Crore, i.e. CDTL's income was 9% of CDEL's consolidated income. Hence, Noticee contended that CDTL was not a material subsidiary

2. **Failure to seek approval of the Board of Directors, Audit Committee and shareholders of the company for entering into Related Party Transactions:** The definition of "related party transactions" under Regulation 2(1)(zc) of LODR Regulations, 2015 pertains only to the transactions between the listed entity and a related party. On the other hand, the transactions referred to in the SCN all pertained to transactions between various subsidiary companies of the Noticee and MACEL. Thus, there was no requirement for obtaining prior approval of the Board of Directors, Audit Committee and Shareholders of the listed company in connection with transactions between the subsidiary of a listed company and a related party of the listed company or any of its subsidiaries. The definition of "related party transactions" under Regulation 2 (1) (zc) was substantively amended only in November 2021 to bring within its purview transactions between a listed entity or any of its subsidiaries on one hand and a related party of the listed entity or any of its subsidiaries

on the other hand. Thus, there was no requirement to take prior approval of the Audit Committee, Board or Shareholders of CDEL. The details of transactions between the 7 subsidiaries of Noticee and MACEL during April 2019 to July 2019, became known only because of the investigation commissioned by the Noticee's Board of Directors culminating in the Investigation Report. Hence, the allegations against the Noticee in respect of these transactions cannot be sustained.

3. **Board of Directors should have acted with due diligence:** SEBI's Investigation Report states that VGS was the sole person who was responsible for directing employees to facilitate the transfer of funds from subsidiaries of the Noticee to MACEL. Therefore, the Board of Directors were unaware of the transfer of funds between April 2019 to July 2019 before the discovery of the suicide letter of VGS on July 27, 2019, which contained his confession. Therefore, the Noticee cannot be said to have violated the provisions of PFUTP Regulations. Noticee further contended that the subsidiaries of the Noticee, including the 7 subsidiaries referred to in the SCN, were incorporated separately and had their distinct and independent board of directors and the key managerial persons who were in charge of the day-to-day functioning of the respective subsidiary. Neither the SCN nor the Investigation Report identify or establish as to how the Noticee is alleged to have violated the provisions of PFUTP Regulations. Noticee further contended that consolidated financial statements containing disclosure of transactions as referred to in the SCN between the 7 subsidiaries of the Noticee and MACEL were circulated to various parties such as shareholders, Registrar of Companies, Stock Exchanges etc. and the statutory auditors of CDEL as well as the 7 subsidiaries of the Noticee, have certified the compliances made by them. Further, the price of the security of Noticee fell due to the sudden news of VGS's unfortunate demise. It was only upon the receipt of the Investigation Report from Mr. Ashok Kumar Malhotra that it became known that during April 2019 – July 2019, 7 subsidiaries of the Noticee were having outstanding dues from MACEL. Since the transactions between the 7 subsidiaries of the Noticee with MACEL were not known, the fall in the price of the security of Noticee cannot be attributed to the same.

4. **Transfer of funds to the tune of Rs. 3,535 Crore from the subsidiaries of CDEL to MACEL was nothing but the fraudulent diversion of funds of CDEL's subsidiaries for the personal benefit of VGS and his family related entities:** Noticee contended that SEBI's own Investigation Report states that VGS was the sole person who was responsible for directing employees to facilitate the transfer of funds from subsidiaries of the Noticee to MACEL and that the Board of Directors was not aware of the transfer of funds between April 2019 to July 2019 before the discovery of suicide letter of VGS on July 27, 2019, which contained his confession. Noticee submitted that the transactions between the subsidiaries of the Noticee and MACEL during the financial year 2018-19 were at all points disclosed in the financial statements of the respective subsidiary, as well as in the Consolidated Financials of Parent Company (i.e. the Noticee). CDGL had a regular coffee procurement relationship with MACEL and these

transactions in the regular course had been duly approved by the audit committee of CDGL and the same was properly disclosed regularly to the concerned authorities. As regards the transfer of Rs. 789 Crore from TRRDPL to MACEL, the same pertained to the sale of shares of Mindtree Ltd to L&T, which was approved by the Board of the Noticee and also disclosed to the stock exchange. Noticee further contended that full disclosure of all transactions was made to all. Therefore, the Noticee cannot be said to have violated the provisions of PFUTP Regulations, as alleged. Noticee further denied the allegation pertaining to violation of PFUTP Regulations and submits that the price of the security of Noticee fell due to the sudden news of VGS's unfortunate demise. It was only upon the receipt of the Investigation Report of Mr. Ashok Kumar Malhotra that it became known that during April 2019 – July 2019, 7 subsidiaries of the Noticee were having outstanding dues from MACEL. Since the transactions between the 7 subsidiaries of the Noticee with MACEL were not known, the fall in the price of the security of Noticee cannot be attributed to the same.

Arguments made by SEBI

1. **Failure to identify material subsidiary:** In this SEBI contended that for deciding whether a subsidiary qualifies to be a material subsidiary or not, either of the two parameters i.e., income or net worth has to be considered. In this regard, SEBI noted following details regarding income and net worth of CDEL and CDTL for FYs 2017-18 and 2018-19:

	CDEL#		CDTL	
	Networth	Consolidated Income	Networth	Consolidated Income
2017-18	3015.46	3851.11	281.06	167.40
2018-19	3166.14	4466.79	415.76	327.25
(# Source: Annual Report of CDEL for FY 2018-19, Pg. 134 -135)				

SEBI noted that while determining whether CDTL qualified to be a material subsidiary of CDEL for FY 2019-20, during the immediately preceding financial year (i.e. FY 2018-19) the net worth of CDTL and CDEL stood at Rs. 415.76 Crore and Rs. 3,166.14 Crore respectively, i.e., net worth of CDTL exceeded 10% net worth of CDEL for that FY. Thus, CDTL qualified to be a material subsidiary of CDEL for FY 2019-20 and that by not declaring CDTL as a material subsidiary in annual reports for FY 2019-20, CDEL has violated the provisions of Regulation 4(1)(a) read with Regulation 16(1)(c) of the LODR Regulations, 2015.

2. **Failure to seek approval of Board of Directors, Audit Committee and shareholders of the company for entering into Related Party Transactions:** SEBI contended that Regulation 2(1)(zc) which defines a 'related party transaction' and Regulation 23 which prescribe the need for approval of Audit Committee and shareholders of a listed company,

prior to their amendment, which was applied prospectively with effect from April 01, 2022 onwards, did not cover transactions involving subsidiaries of a listed company and only after the amendment, the said provisions now include transactions involving subsidiaries. Although, when the transactions in question involving transfer of funds from subsidiaries to MACEL were done, though the amended provisions in Regulation 2(1)(zc) and Regulation 23 had not come into effect, CDEL on its own ought to have treated its subsidiaries as equivalent to a listed company (i.e. itself), since it derived all its value from its subsidiaries and had no inherent value of its own. Also, the Red Herring Prospectus (RHP) of CDEL that was filed with ROC at the time of its going public in 2015 inter alia stated that CDEL was dependent on subsidiaries to generate revenues. Further it was highlighted that CDEL had ownership interests in subsidiaries. It was also stated that CDEL lacked substantial operations and fixed assets within our Company and all its operations were conducted through our Subsidiaries. Thus, CDEL should have sought approval of Board of Directors of the company, Audit Committee and shareholders, as may be applicable as a part of good corporate governance. SEBI further stated that in such circumstances, it should have followed the spirit of the pre-amended regulation by treating the concerned transactions as related party transactions and following the norms applicable to such transactions. Considering the same, though I am convinced that the Noticee had not followed the prescribed norms for related party transactions, I am constrained to let off the Noticee in this respect purely on technicalities.

3. **Board of Directors should have acted with due diligence:** SEBI contended that Noticee has grossly failed in ensuring that its directors, key managerial personnel and promoters or those belonging to the subsidiaries acted in conformity with responsibilities and obligations assigned to them under LODR Regulations, 2015. SEBI further highlighted that Noticee has itself admitted that VGS, the Promoter and CEO, was running the entire show within CDEL and its subsidiaries. It has further admitted that VGS used to collect the signed blank cheques and all the fund transfers were done by him. I find that this amounts to an admission by the Noticee that the listed company was being run like a personal fiefdom with no checks and balances in place. Nothing, it appears, could have prevented the diversion of funds from the subsidiaries of CDEL. The manner in which VGS operated, as disclosed in the Investigation Report of Mr. Malhotra and admitted by the Noticee, rather than being a clean chit to the Noticee, amounts to a clear indictment of the Noticee for its wilful dereliction of duty of ensuring that its directors, promoters and KMPs acted as per prescribed procedures. Accordingly, Noticee shall be held guilty of violation of Regulation 5 of the LODR Regulations, 2015.

4. **Transfer of funds to the tune of Rs. 3,535 Crore from the subsidiaries of CDEL to MACEL was nothing but the fraudulent diversion of funds of CDEL's subsidiaries for the personal benefit of VGS and his family related entities:** SEBI contended that though MACEL had a large balance sheet, it had negligible operations and had negative net worth. The revenues of MACEL during 2018-19 and 2019-20 (the years during which the

fund diversion to MACEL had occurred) were merely Rs. 1.71 Crore and Rs. 3.27 crore respectively and it was running into losses. All its borrowings were taken almost entirely from Related Parties and were almost entirely utilized for giving Long Term Loans and advances to its Related Parties. SEBI stated that this shows that MACEL was merely acting as a pass-through entity between one set of related parties to other set of related parties. SEBI further highlighted that despite the extremely weak financial position of MACEL, the subsidiaries of CDEL decided to advance funds to the tune of Rs. 3,535 Crore to MACEL. This sum was more than the net worth of the Noticee, Rs. 3,166 Crore as of March 31, 2019. Of the sums transferred from 7 subsidiaries of CDEL to MACEL during the FYs 2018-19 and 2019-20, two subsidiaries (TRRDPL and GVIL) had no revenue from their own operations and yet they transferred a total of Rs. 1,420 Crore to MACEL. Similar observations are made in respect of other subsidiaries, viz. TDL, GVIL, CDHRPL and CDEPL. SEBI further noted that it appears that the funds which were transferred from these subsidiaries to MACEL had come from other sources and that these subsidiaries had merely acted as conduits for transfer of funds to MACEL. SEBI further stated that this can also be said of MACEL too as it had limited or virtually no operations but acted as a pass-through entity for further transfers to related parties. As it was stated that the transfer of funds from subsidiaries companies to MACEL after April 01, 2019, was done by VGS without recording the purpose of such transfer it is clear that entire operations within CDEL including its subsidiaries was loosely controlled with no well-defined structures. SEBI further highlighted that Late S.V. Gangaiah Hegde, father of VGS, held 91.75% shares of MACEL. SEBI stated that further analysis of bank statements and information available shows that almost entire money received by MACEL from the subsidiary companies of CDEL was diverted to VGS, his wife and other related entities of VGS thus making VGS and his immediate family members and related parties the direct beneficiaries of the funds transferred from subsidiaries of CDEL. Thus, the transfer of funds to the tune of Rs. 3,535 Crore from the subsidiaries of CDEL to MACEL was nothing but a fraudulent diversion of funds of CDEL's subsidiaries for the personal benefit of VGS and his family related entities. The said diversion of funds had an adverse effect on the price of the scrip of CDEL (share price fell by almost 90% after the fraud came to light) leading to massive erosion of shareholder's wealth. SEBI further stated that even if the fund diversion was done by VGS it cannot be denied that the was holding the position of Chairman and MD of CDEL and had acted and taken all decisions in respect of the said transfers in his official capacity. Considering the same, the role of the MD and Chairman cannot be separated from that of the Company and they ought to be treated as one and the same as far as the issue of accountability and liability is concerned. Thus, CDEL as a company is accountable for the abovementioned fraudulent transfer of funds from subsidiary companies to MACEL and consequently has violated the provisions of Section 12A(a), (b) & (c) of the SEBI Act, 1992 read with Regulations 3(b), (c) & (d) and 4(1) of the PFUTP Regulations.

Held

Penalty of Rs. 25,00,00,000 (Rupees Twenty-Five Crore) under Section 15HA and Rs. 1,00,00,000 (Rupees One Crore) under Section 15HB of the SEBI Act, 1992 in addition to this SEBI has ordered recovery of funds from MAECL by way of appointing an independent law firm. SEBI has further stated as follows, "*…while the directors and KMPs (past and present) of CDEL and its subsidiaries have not been made a party to the current proceedings, I feel that considering the manner of fund diversion, as disclosed above, it is imperative to carry out a detailed examination of acts and omissions of such persons by lifting the corporate veil, which is a widely accepted canon of corporate jurisprudence and has been followed by SEBI in many cases in the past…*"

IBC

In the matter of Tata Steel BSL Ltd. ("Appellant") Vs. Venus Recruiter Private Ltd. & Ors ("Respondent") passed in the Delhi High Court dated January 13, 2023

Facts of the Case

- State Bank of India ("**SBI**") filed a petition, u/s 7 of the Insolvency Bankruptcy Code ("**IBC**") before the National Company Law Tribunal ("**NCLT**") New Delhi for initiation of Corporate Insolvency Resolution Process ("**CIRP**") of M/s Bhushan Steel Limited ("**Corporate Debtor**"/"**CD**") on default in repayment of its credit facilities. On July 26, 2017, the NCLT passed an order admitting CD to CIRP.
- A public announcement was made and claims were invited by prospective resolution applicants and a Committee of Creditors ("**CoC**") was constituted. The CoC approved the resolution plan on March 20, 2018, proposed by Tata Steel Ltd ("**TATA**") and Resolution Professional ("**RP**") filed the resolution plan proposed by TATA before the NCLT for its approval in terms of Section 31 of the IBC. On April 03, 2018, after the filing of the resolution plan but before its approval, the Forensic Auditor of CD, Deloitte, submitted a Forensic Audit Report of the CD to the RP.
- The report disclosed several suspect transactions that were entered into by the CD, with various parties including the Respondent.
- On October 03, 2009, CD had entered into an agreement for the supply of manpower with the Respondent which contained a clause stipulating payment of the 10% service charge to the Respondent in lieu of the manpower supplied under the agreement. The allegation was that the 10% service charge was paid in lieu of manpower supply could have been preferential in nature.
- On April 09, 2018, the RP filed an application before the NCLT, being u/s 25(2)(j), sections 43 to 51 and Section 66 of the IBC wherein various transactions were enumerated as 'suspect transactions' with related parties avoidance application.
- On May 15, 2018, NCLT approved the Resolution Plan of TATA filed by the RP before the NCLT.
- On May 18, 2018, the Resolution Plan was implemented in finality and the new management being i.e., TATA assumed control of CD.
- NCLT observed that the avoidance application, had been filed by RP on April 9, 2018 prior to the approval of the Resolution Plan and proceeded to issue notice to the Respondent companies who were made a party to the application.

- Parallel, on August 10, 2018, the NCLAT upheld the Order dated May 15, 2018, passed by the NCLT approving the Resolution Plan of TATA. Aggrieved by the Order of the NCLT issuing notice in the avoidance application, the Respondent filed a writ petition for writ declaring the proceedings borne out of the avoidance application, pending before the NCLT, as void and non-est since CIRP had concluded and the successful Resolution Applicant, TATA had assumed control of CD in terms of the IBC.

Arguments of the Appellant TATA - New Management of the CD

- Avoidance applications are to be filed as per the provisions of the IBC and the Ld. NCLT is the appropriate and concerned forum for the same. Further, Sections 44, 48, 49, 51, 66 and 67 of IBC categorically provide for the NCLT to pass orders in respect of avoidance applications. Further, referred the matter of ***Indian Oil Corporation Limited versus Union of India and Ors.***, dt December 23, 2019, wherein this Court had refrained from interfering in to stay orders passed in respect of invocation of certain bank guarantees provided by a corporate debtor and proceeded to remand the matter to the NCLT.
- The Ld. Single Judge erred in holding that an avoidance application cannot be heard after the conclusion of CIRP.
- The requirement of the IBC, as is evident from the wording of Section 25(2)(j), is that the RP is only required to file an avoidance application and that burden has been discharged in the present matter. Section 26 of IBC clearly states that while the RP during his/her tenure is required to collate information and, on the basis of the same file an Avoidance Application during CIRP, the same need not be completed during CIRP and neither will the pendency of the same delay and/or affect the CIRP.
- Further, Section 26 of IBC envisages that the timelines under the IBC for the purposes of CIRP cannot be extended to proceedings borne out of avoidance applications. Timelines under the IBC and its rules and regulations are indicative in nature, endeavouring to make the whole process time-efficient whereas proceedings under the IBC are more often than not, subject to extensions granted by NCLT.
- Attention was drawn to Chapter 3 of the ILC Report dated Feburary 20, 2020, which stated that proceedings for avoidable transactions should be initiated by the RP during the CIRP or liquidation process and prescriptive timelines for initiating such proceedings may not be necessary. The Report further stated that resolution plans may provide for the preservation of claims and the manner of pursuing such type of proceedings after the plan is operational, therefore, such proceedings were never envisaged to be bound by strict timelines. The timeline within Regulation 35A only requires the RP to form an opinion, and determine and file an application before NCLT. There is no timeline for the NCLT to adjudicate such applications, once filed.
- Proceedings pertaining to avoidable transactions, by their very nature are such that they meet resistance. IBBI acknowledged the same in its Discussion Paper on Corporate Liquidation Process dated April 27, 2019. Filing an avoidance application under Section 25 of IBC by the RP would not affect the proceedings of the CIRP. Therefore,

being independent of CIRP, avoidance proceedings can continue parallelly and beyond CIRP.

- Reliance has also been placed on IBBI's document titled ***Dealing with Avoidable Transactions*** dated March 27, 2019 which acknowledged that applications may not be adjudicated before the conclusion of CIRP and such an eventuality is acceptable in view of Section 26 of IBC.
- Reliance was also placed on the ***Draft statement on Best Practices – Role of Ips in avoidance applications*** wherein it is stated that the application for avoidance transactions is against the promoters/directors/related parties, however, the resolution/liquidation is for the Corporate Debtor, making this separate class of proceedings and should therefore, these two should be treated separately. Even if the corporate debtor is resolved/liquidated, the application of avoidance transactions should be carried on.
- The ***ILC report in Para 2 of Chapter 3*** suggests that the Adjudicating Authority should decide whether the recoveries from actions filed against improper trading or to avoid transactions should be applied for the benefit of the creditors of the corporate debtor, the successful resolution applicant or other stakeholders. The IBBI itself recommends the Resolution Applicant to pursue the Avoidance Proceedings if CIRP ends with a Resolution Plan.
- Ld. Single Judge has erred in observing that the purpose of avoidance of transactions is for the benefit of the creditors of the Corporate Debtor and that no benefit would come to the creditors after the Plan is approved. The approval of the Plan has no nexus with benefits to creditors.
- If the Impugned Judgment was allowed to continue, it would directly result in all pending Avoidance Applications post CIRP being rendered infructuous thereby destroying the relevant provisions of the IBC, making avoidance applications nugatory, permitting wrong-doers who have participated in extracting monies beyond fair-market value, related parties taking advantage of unjust enrichment without any consequences and directly causing losses to the creditors and the corporate debtor in terms of value

Arguments of the Union of India

- The RP was discharging a statutory function while forming an opinion that a transaction should be avoided under the provisions of the IBC. It is performing a statutory function for initiating proceedings in this regard before the NCLT. The avoidance proceedings are not personal to the insolvency professional acting as the RP. A perusal of the nature of orders that can be passed under Section 44, suggests that the immediate recipient of the outcome of the avoidance proceedings is the corporate debtor. Therefore, after the conclusion of the CIRP, the office of the RP does not become functus officio and the avoidance proceedings do not come to an end.
- Regulation 35A does not specify any adverse consequence in case of the failure of the RP to file the avoidance application in terms of the timelines provided therein, therefore indicating that such timelines ought to be treated that the timelines provided under

Regulation 35A may only be treated as directory and not mandatory.

- Reliance has been placed upon other provisions of the IBC such as Section 47, which provides that where RP or liquidator do not report the undervalued transactions, the creditor, member or a partner of the corporate debtor may make an application to the NCLT to declares such transactions as void and reverse their effect, further the argument that the impugned judgment was not based on sound reason insofar it holds that when RP becomes functus officio, the PUFE applications cannot be decided. Hence, the adjudication of avoidance transaction does not depend upon filing by RP or time lines of CIRP.
- There are two purposes for providing provisions for the avoidance of certain transactions-
  - for the benefit of the creditors in general and a fair allocation of an insolvent debtor's assets to the creditors
  - to create a fair commercial conduct before the declaration of insolvency and have deterrent effect to discourage creditors from pursuing individual remedies in the period leading up to insolvency.
- The implications of these provisions are restricting the right of parties to such transactions to benefit the same by sending the proceeds back to the corporate debtor also incidentally benefitting creditors. In the said case, the avoidance proceedings were subsisting after approval of the resolution plan by the NCLT and the conclusion of CIRP. While incidental benefits to the creditors during the CIRP do not exist anymore, such proceedings do not become infructuous as parties to such impermissible preferential transactions are still benefiting out of the same.

Arguments of the RP

- The Respondent cannot be allowed to go scot-free merely because the RP is rendered functus officio under Sections 30, 31 of the IBC.
- There exists no requirement for the RP to pursue the avoidance application and the same can be done by the Corporate Debtor upon the successful resolution of the CIRP. The Corporate Debtor being the beneficiary of the recovered monies under an Avoidance Application in the first instance, would be entitled to substitute the Resolution Professional and pursue the Avoidance Application. Such an eventuality would be entirely consistent with the scheme of the IBC.

Arguments of the Respondent

- The jurisdiction of the NCLT ceases to exist since Section 60 of the IBC provides that the NCLT is the Adjudicating Authority in relation to the insolvency resolution process and liquidation for corporate persons. Therefore, all powers, authority and jurisdiction conferred upon the Adjudicating Authority have to be construed in the context of either a CIRP Process or Liquidation Process. If there is neither a CIRP Process nor a Liquidation Process, then the Adjudicating Authority has no jurisdiction.
- That IBC being a law providing for the resolution of a corporate debtor in a time bound manner, does not provide for the continuation of an avoidance

application after the conclusion of CIRP. In *Innoventive Industries* wherein the Hon'ble Supreme Court held that the raison d'etre of the IBC, taking into account numerous committee reports, expert discussions, Statement of Objects and Reasons and the legislative history, was to emphasize upon the necessity for speedy resolution under the IBC while recording the serious problems under the previous legal framework. Therefore, the wordings of Section 26 of IBC, when accorded literal interpretation, the phrase "shall not affect the proceedings of the corporate insolvency resolution process" is construed to mean that the CIRP proceedings shall be parallel to the Avoidance proceedings. Appellants seek to introduce the word "by" and change the phrase to "shall not be affected by the proceedings of the corporate insolvency resolution process". This misconceived interpretation alters the entire meaning of Section 26 of the IBC since by means of Section 26 of the IBC, the Parliament has retained the focus of the proceedings before the Adjudicating Authority only to the CIRP process. With the interpretation advanced by the Appellants, the focus is shifted to Avoidance Application which was never the intention of the Parliament.

- The tenure of the RP cannot be extended beyond CIRP.
- Section 23(1), demonstrates that the role of the Resolution Professional is confined to:
  - — conduct of the CIRP;
  - — managing the operations of the corporate debtor during the CIRP period; and
  - — if a resolution plan has been submitted to the Ld. Adjudicating Authority, then to continue to manage the operations of the corporate debtor until the plan is approved by the Ld. Adjudicating Authority.
- Further, in terms of Section 30(2)(a) of the IBC, the resolution plan has to necessarily provide for payment of the insolvency resolution process costs. Such costs in terms of the definition of "insolvency resolution process cost" under Section 5(13) of the IBC includes the fee payable to any person acting as a Resolution Professional. This is an indicator of RPs limited role.
- Reliance was placed upon Section 31(3)(b) of the IBC which states that upon approval of the resolution plan by the Ld. Adjudicating Authority, the RP is bound to forward all records relating to the conduct of the CIRP and the Resolution Plan to the IBBI, which demonstrates that the process culminates upon approval of the resolution plan by the Ld. Adjudicating Authority. Under Section 43(1) of the IBC, an application for the avoidance of preferential transactions may only be preferred by a RP or a liquidator. Since RP is functus officio and the mandate of Section 43 is that only RP can pursue the application, no other person can be allowed to do so.
- Sections 43 and 44 of the IBC lay down an exclusive statutory framework wherein, transactions, which cannot be normally avoided by a company under the general law, may be avoided to (a) make the Corporate Debtor attractive for the Resolution Applicant to bid; (b) bring back secreted funds to the Committee of Creditors; (c) keep the Corporate Debtor a going concern. It was further claimed that in the present

case, the proceedings achieve neither of the avowed objectives of avoiding a so-called preferential transaction. This is because the Resolution Applicant i.e., TATA did not make avoidance of the transaction with Venus the basis of its bid. The CoC has already issued a "No dues Certificate" after the receipt of monies from TATA. The CD was always a going concern and the Venus" contract did not affect its status

Held

- The High Court analysed the scope of avoidable transactions and survival of Avoidance applications beyond CIRP. Also, highlighted the fact that IBC being a special statute endeavouring to ensure that the resolution process is time bound and efficient and Regulation 35A of CIRP Regulations is in line with this object in attempting to make sure that an avoidance application is determined and filed at the earliest to facilitate resolution of the CD. The Court also highlighted the role of RP.
- The High court further highlighted that the scheme of IBC is just not a commercial call taken by the CoC. It was enacted by the legislature to ensure maximum recovery due to the creditors. The endeavour must always be to ensure maximum recovery of that money to the CoC because it is public money and the public cannot be made to suffer on account of dubious/ nefarious transactions entered into by the company. The price that has been offered by a resolution applicant is a commercial decision. Resolution Applicant has accepted to take over the entity at a particular price. Resolution Applicant cannot be a beneficiary of that amount because that amount was actually paid by the CoC which is public money.
- The High Court also highlighted that the CIRP regulations were also amended to take care of this and cannot be interpreted to extinguish proceedings pertaining to avoidable transactions in resolution plans submitted before June 14, 2022 (amendment date) altogether.
- It was held that adjudication of an avoidance application is independent of the resolution of the CD and can survive CIRP. In cases wherein such transactions could not be accounted for at the time of submission of resolution plans, the AA will continue to hear the avoidance application.
- The amount that is made available after transactions are avoided cannot go to the kitty of the resolution applicant. The benefit arising out of the adjudication of the avoidance application is not for the corporate debtor in its new avatar since it does not continue as a debtor and has gone through the process of resolution. This amount should be made available to creditors who are primarily financial institutions and have taken a haircut in agreeing to accept a lesser amount than what was due and payable to them.
- The NCLT was directed to proceed ahead with the hearing of the avoidance application. In accordance with Sections 44 to 51 of the IBC, 2016, the amount which would be recovered could be distributed amongst the secure creditors in accordance with law as determined by the NCLT. With these observations, the appeals are disposed of, along with pending application(s), if any.

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