UNDERSTANDING PREFERENTIAL TRANSACTIONS IN INSOLVENCY AND BANKRUPTCY CODE: THE POOJA BAHRY CASE

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ABSTRACT

The Insolvency and Bankruptcy Code seeks to check preferential transactions where corporate debtor gives preference to some creditors over other. Section 43(2) outlines criteria for identifying preferential transactions during insolvency proceedings, focusing on transactions benefiting creditors or guarantors. In this article, the interpretation, applicability and effectiveness of this provision is thoroughly analyzed through the lens of the Pooja Bahry case. Despite ambiguities, the court emphasized the strict application of Section 43(2) to prevent misuse of preferential deals. The effectiveness of this section lies in its provision of clear standards for recognizing preferential transactions, ensuring fairness and transparency in insolvency resolution processes. The analysis underscores the importance of adhering to statutory frameworks and legislative intent to uphold justice in insolvency proceedings.

Keywords: Bankruptcy, IBC 2016, debt, corporate, adjudicating authority

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INTRODUCTION

The Insolvency and Bankruptcy Code, 2016 designates as "avoidance transactions" those transactions that have an effect on the fiscal stability of a bankrupt company through the Corporate Insolvency Resolution Process or liquidation. These consist of undervalued, fraudulent, preferential, and credit-defrauding transactions. Assessing avoidance transactions according to purpose, adjudicating authorities typically go beyond precise legal wording limits in insolvency, given the burden placed on possible defaulting parties. One such clause in the Code that addresses this dispute is Section 43.

'Avoidance transactions' throughout insolvency are covered according to Section 43 of the Insolvency and Bankruptcy Code (IBC), which classifies them as preferential, undervalued, fraudulent, and transactions that deceive creditors. It sets a two-year lookback time for such related transactions and a one-year lookback time for unrelated transactions. Preferential transactions which can happen prior to the start of the CIRP resolution procedure are covered under Section 43(2) of the IBC.[1] According to this, an agreement involving the transfer of an asset or interest for the advantage of a creditor, surety, or guarantor which is connected to a prior monetary obligation or additional debt incurred from the corporate debtor and occurs at a pertinent period could possibly be deemed preferential. The purpose of this clause is to stop the corporate debtor from giving preference to some creditors against others throughout the CIRP process.

ESSENTIAL ELEMENTS OF SECTION 43(2) OF IBC

An agreement qualifies as preferential under Section 43(2) of the Code when it involves the transferring of a Corporate Debtor's asset or interest to another creditor, surety, or guarantor for the purpose of satisfying past monetary obligations, operational debts, and other responsibilities. Compared to the case where funds were allocated in accordance with Section 53, this transfer puts the aforementioned creditors in a better position.[2] Put otherwise, a

[1] Shaivi Bhamaria, 'Delving Further into Preferential Transactions: NCLAT Studies Section 43 in Light of Jaypee Ruling, SC Upholds – Vinod Kothari Consultants' <https://vinodkothari.com/2023/08/delving-further-into-preferential-transactions-nclat-studies-section-43-in-light-of-jaypee-ruling-sc-upholds/> accessed 16 February 2024.

[2] 'REEDLAW: "Preferential Transaction" and "Relevant Time" under Section 43 of IBC' (*REEDLAW*) <https://www.reedlaw.in/articles/%22preferential-transaction%22-and-%22relevant-time%22-under-section-43-of-ibc> accessed 16 February 2024.

transaction that involves paying back debts and puts a creditor in a favourable position constitutes as preferred. Transfers mandated by the court may also be considered preferable.

By preventing corporate debtor preferences from taking precedence over CIRP, Section 43 protects impartial asset allocation. Having few exemptions, it nullifies any transfers of assets or interest that are advantageous to a creditor or surety or guarantor with regard to prior obligations in the pertinent period, guaranteeing that no one is unfairly given a lead over what would have existed in the absence of the transfer.[3] Enhancement is the fundamental component of the transaction. The result of the arrangement is emphasised in Section 43(2)(b), guaranteeing that the recipient's situation is better than according to Section 53. The person who receives it may not get the entire amount due in the case of an insolvent company. The amount lost is contingent on where the recipient is in the payment sequence. Importantly, the law places emphasis on the influence of placing this creditor, emphasising the effects of the settlement regardless of its purpose or intention.

In order to ascertain whether a transaction is subject to Section 43 of the IBC, the adjudicating authority created a methodical procedure. According to Section 43(2)(a) IBC, the procedure of determining whether the transaction favours the creditor or surety or guarantor for previous monetary obligation is initially carried out by the Resolution Professional and then by Tribunals through Section 44 IBC petitions. According to Section 43(2)(b) IBC, it evaluates whether the agreement places the parties in a better position compared to asset allocation as per Section 53 of the Code.[4] It also takes into account the duration of the related party for a period of two years, or, as an alternative, one year, as per Section 43(4) IB, and verifies that the transaction is not exempted pursuant to Section 43(3) of the Code. Resolution Professionals and Adjudicating authorities can read CIRP cases more easily because to this simplified method, which also increases assurance in the process.

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[3] Pratyush Singh, 'The Need to Revisit the Exception of "Ordinary Course of Business" under IBC' (*IRCCL*, 25 May 2023) <https://www.irccl.in/post/the-need-to-revisit-the-exception-of-ordinary-course-of-business-under-ibc> accessed 16 February 2024.

[4] Guest, '"Ordinary Course of Business" Defence under the IBC: Origin and Scope' (*IndiaCorpLaw*, 14 September 2021) <https://indiacorplaw.in/2021/09/ordinary-course-of-business-defence-under-the-ibc-origin-and-scope.html> accessed 16 February 2024.

INTERPRETATION OF SECTION 43(2) OF IBC

Because there are certain circumstances and standards that must be fulfilled in order for an arrangement to be considered preferred, Section 43(2)'s wording is not straightforward. It states that a transaction shall be deemed preferred if it satisfies the requirements outlined in subsection clauses (a) and (b), that include having connected to liabilities owing by the corporate debtor and benefitting a creditor or guarantor. Because of this, Section 43(2)'s wording is intricate and technical, necessitating a close analysis of the transaction in issue to ascertain its preferential character. With a precise and simple framework, Section 43(2) focuses on recognising preferred transactions according to predetermined standards pertaining to financial liabilities and creditor advantages.

A transaction is considered preferential according to Section 43(2) of the Code if it satisfies the following two requirements: (a) the proceeds are for the advantage of a creditor or surety or guarantor, as well as (b) it places the parties in an advantageous place compared to they might have obtained pursuant to Section 53 asset allocation. Preferences have to happen within the pertinent period, that is interpreted separately depending on whether or not the preference is granted to an unrelated party or a related party, in order for them to be deemed violations under Section 43. Particular transactions are exempt from arising within sub-section (2) by Section 43(3). These transactions include transfers done in the regular conduct of company operations of the corporate debtor's monetary or commercial activities or transfers that create an interest in security which guarantees new worth at a predetermined period.

Section 43(2) has a problem in that it considers any transaction that satisfies the requirements in sub-sections (4) and (2) to be preferential regardless of whether it could have been incorrectly meant to be so. A further issue with Section 43(2)'s fictional nature is that it might have unexpected repercussions, such as treating transactions made by a corporate debtor as preferential without taking into account their true intentions.[5] Furthermore, it might be argued that the condition that the preference had to have happened within a given pertinent period is flawed since it does not necessarily reflect the actual type of the transaction or how the corporate debtor was doing financially during transaction.

[5] IBBI, 'Judgment1 Dated 26th February, 2020 of the Hon'ble Supreme Court of India i' <https://ibbi.gov.in/uploads/whatsnew/c1ae27b5ad2d0df6cb82a2fa9e544641.pdf>.

THE POOJA BAHRY CASE

Facts of the Case:

In this instance, the corporate debtor is NTL Electronics Private Limited, a manufacturer of electronic goods, of whom Mr. Arun Gupta being the managing director. The related party of the corporate debtor is Keshika Exports Private Limited. There is a prior debt between Mr. Praveen Gupta and the Corporate Debtor. Despite not being related to the corporate debtor, the appellant companies, GVR Electronics and GVR Consulting Services Private Limited, used an extended loan arrangement to support their commercial activities. In 2018, they fulfilled their obligation to repay these outstanding unsecured debts. At the Committee of Creditors meeting, NTL Electronics chose Pooja Bahry as its Resolution Professional.[6] The RP asserted that pursuant Section 43 of the IBC, some transactions pertaining to settlement between the appellants' GVR and the corporate debtor were preferential transactions and were thus to be scrutinised.

The resolution professional claimed that the transactions were preferential as they were carried out outside of the regular company operations and submitted an application to the adjudicating authority pursuant section 43 of the Code. Through the creation of interest or benefit or passing on of property, these agreements grant favours to particular creditors for prior liabilities. The RP aimed to prevent other creditors from suffering as a result. At the forefront of the dispute concerning this provision is the question of whether a transaction satisfies the standards in provision 43(2) to be categorised as a preferential transaction. It comprises assessing if a corporate debtor's transfer of interest or property advantages a surety, guarantor, or creditor plus if it is related to the debtor's previous financial obligations.[7] The primary concern relates to if the transaction meets the conditions specified in Section 43(2) to be deemed preferential and maybe susceptible to the consequences of Section 44 of the Code.

Contentions of the Parties:

The primary points of contention for the appellants were their position as unrelated parties, the regularity of the transactions, and their objection to the Resolution Professional's application.

[6] Ritu, 'Intent of Corporate Debtor Irrelevant in Preferential Transaction under IBC: NCLAT' (*SCC Blog*, 4 May 2023) <https://www.scconline.com/blog/post/2023/05/04/intent-corporate-debtor-irrelevant-preferential-transaction-nclat-legal-news/> accessed 16 February 2024.

[7] Ibid.

Under Section 43 of the Code, the appellants' counsel attempted to prove that the aforementioned transactions did not constitute preferential. The appellants contend that the corporate debtor's regular conduct of business or financial operations ought not to serve as the exclusive basis for considering the transaction under examination under Section 43(2) as preferred. They stress that while evaluating if a transaction is covered by Section 43(2) of the Code, consideration must be given to the intention of insolvency laws. Although the appellants argue that Section 43 must be interpreted strictly, it is important to remember the underlying purposes and intentions of the clause. The appellants contend that, irrespective of the real purpose, any transaction satisfying the requirements listed in subsections (4) and (2) of Section 43 is considered preferential.

The appellants also argued that Corporate Debtor was just fulfilling repayments to its secured lenders and that the Resolution Professional lacked the jurisdiction to bring the avoidance application, as was covered in *Venus Recruiters Private Limited vs Union of India*. They cited the UNCITRAL Legislative Guide on Insolvency Law in reference to interpret regular operations of company and avoidance proceedings. *PG Vivekanandan vs RPS Benefit Fund Limited* was cited by the appellants to support their position that the entity's primary reason for the transaction should be given consideration.[8] They further emphasise that the transaction ought to be regarded as preferential under Section 44 of the Code because of the jurisprudence that is in place because of the presence of particular elements in the agreement between the parties.

After three months of the order date, the respondents are required to return the money. The failure of the responders to deposit the stated sum during the allotted time frame may result in legal recovery. Lender influence led to the aforementioned transactions, involving the issuing of security checks and demands for repayment in penalty of lawsuit. The respondents in the arguments are unrelated to the Corporate Debtor, and it was argued that the preferential transactions constituted related to regular company operations. Considering the appellants' concerns, the Resolution Professional's composite application, filed pursuant many provisions of the Code, was deemed maintainable by the Court.

[8] Shaivi Bhamaria, 'Delving Further into Preferential Transactions: NCLAT Studies Section 43 in Light of Jaypee Ruling, SC Upholds – Vinod Kothari Consultants' <https://vinodkothari.com/2023/08/delving-further-into-preferential-transactions-nclat-studies-section-43-in-light-of-jaypee-ruling-sc-upholds/> accessed 16 February 2024.

Although the Apex Court previously presented a precise construction of Section 43 in Anuj Jain, IPR for *Jaypee Infratech Limited vs Axis Bank Limited and Others,* the respondent this case, to strengthen their position. They thought that the Apex Court's view in the Anuj Jain judgement had become definitive, hence the rulings of foreign courts and other judgements listed by the appellant's counsel were irrelevant. The defendant sought to highlight the fact that the Apex Court has already dealt with the particular statutory framework in question by citing the Anuj Jain case, hence further references were deemed redundant when analysing Section 43(2). [9]The respondents contended that, irrespective of its true character, any transaction satisfying the requirements listed in Section 43 sub-sections (4) and (2) ought to be regarded as preferential. It was emphasised that these clauses establish a legal assumption that, regardless of the original purpose of the transaction, results in the implications listed in Section 44. In order to accomplish the stated statutory objective, the respondents emphasised how crucial it is to read these insolvency laws carefully.

Analysis of preferential transactions:

According to the judge's reading of the Section 43(2) of IBC, if both of the conditions of clauses (a) and (b) are fulfilled, a corporate debtor will be considered to have granted preferential treatment at a pertinent period. This implies that, irrespective of the real purpose or nature of the agreement, it is regarded to be a preferential transaction if the requirements listed in clauses (a) and (b) of Section 43(2) are satisfied. The court stressed that the transaction would be considered as preferential under Section 44 of the Code, with the associated implications, and that the jurisprudence established by Section 43(2) only applies if the circumstances listed above are met.

The extent and boundaries of preferential transactions were examined by the Apex Court in the Anuj Jain judgement in relation to Section 43 of the Code. The case made it clear that a transaction's intention or motivation is irrelevant in establishing whether it is preferential. This indicates that instead of considering the parties' motives, the emphasis is on the precise legal criteria and components needed to establish a preferential transaction. The decision also demonstrated how the Code's statutory framework differentiates between fraudulent and preferential transactions and establishes distinct standards.

[9] Umakanth Varottil, ‘Supreme Court Rules on Preferential Transactions in Insolvency’ (*IndiaCorpLaw*, 1 March 2020) <https://indiacorplaw.in/2020/03/supreme-court-rules-on-preferential-transactions-in-insolvency.html> accessed 16 February 2024.

The Adjudicating Authority stressed that the word "and" ought to be interpreted as interconnected of both of the terms, "corporate debtor" with "transferee," when it appears as an independent between them in Section 43(2). [10]By taking this action, the court guaranteed that the investigation's trajectory, that focuses on the corporate debtor's activities and affairs—would not be deviated from. The judge also emphasised that exception ought not to depend only on the transferee's regular conduct of operations or financial transactions, including lending banks or other financial entities, as that could essentially circumvent the purpose of the clause. It was also established a series of considerations that must be addressed to be able to ascertain if a particular transaction is covered by Section 43.

The judgement indicates that irrespective of their actual intention, transactions qualifying within the categories in Section 43 sub-sections (4) and (2) are assumed to be preferential. Subsequent rulings on whether a transaction qualifies as a preferential one would probably take into account the presuming provisions of sub-sections (4) and (2), which might result in the prevention of these kinds of deals pursuant the provisions of Section 44 of the IBC. [11]The conclusion, however, might not be entirely clear on how to approach situations in which transactions that come under Section 43(2) are not obviously preferential. It does not cover any difficulties in demonstrating preferential transaction purpose or predictability. Presenting more thorough tests on how to differentiate between preferred and regular business transactions and laying standards used to establish the pertinent period for preferential transactions as per Section 43(4) could have been helpful. The judgement emphasises how crucial it is to read Section 43 strictly in order to stop the misuse of preferential deals. It emphasises how resolution experts must carefully take into account Section 43 obligations when submitting similar application to the Adjudicating Authority.

EFFECTIVENESS OF SECTION 43(2) OF IBC:

Given the circumstances, it appears that Section 43(2) of the Code is an essential clause pertaining to transactions that take place during insolvency procedures. It describes the circumstances wherein an agreement could be seen as preferential at a pertinent period. The section highlights that a transfer of property or interest that benefits a creditor may nevertheless

[10] '"Preferential Transactions" Section 43(3)(a) of the IBC : An Exception to Preferential Transactions - Bhatt & Joshi Associates' <https://bhattandjoshiassociates.com/section-433a-of-the-ibc-an-exception-to-preferential-transactions/> accessed 16 February 2024.
[11] Ibid.

fall beyond the purview of subsection (2) of Section 43 because of the exception outlined in paragraph (3) of Section 43, even if it satisfies the requirements outlined in subsections (4) and (2) of Section 43 of the Code.[12]

The Apex Court emphasised in the Anuj Jain case the distinctions between the criteria in Sections 43, 45, and 66 of IBC and the necessity for the Resolution Professional to take these distinctions into account while submitting an application to the Adjudicating Authority. It is indicated that Section 43 does not consider the original purpose of the transaction and that the presence of specific elements may cause a transaction to be considered granting preference to any creditor or guarantor at a pertinent period. It also expands on the necessity of interpreting the laws with a purpose in mind to make certain that they serve the stated legislative intention. The IBC's stringent interpretation of Section 43(2) guarantees justice for both appellants and respondents. This section delineates the standards for recognising preferential transactions and details the pertinent period intervals during which they are considered preferential. This guarantees a fair and transparent procedure for all parties participating in the corporate insolvency resolution process by ensuring that any assessment of preferential transactions is based on precise and unambiguous parameters. In order to adequately ensure justice in the execution of these laws, the text further emphasises the necessity for resolution professionals to take into account the particular criteria of Sections 43, 45, and 66 while submitting applications to the Adjudicating Authority.

CONCLUSION

The Insolvency and Bankruptcy Code, 2016 states in Section 43(2) that while evaluating if a preferential transaction took place, the corporate debtor's objective fails to be taken into account. Upon thorough reading, the tribunal finds that an arrangement is regarded favoured as long as specific conditions are met, even in cases where the debtor may not have had the best of motives. A more accurate and detailed reading of Section 43(2) has resulted from these instances, providing an improved transparent structure for deciding preferred transactions in CIRP procedures. The rulings emphasise the significance of following the standards established by the clause and offer a more methodical means of ascertaining the preferential character of agreements.

[12] 'Panel Discussion with Ritesh Kavdia, Adv. Nipun Singhvi & IP Pooja Bahry - YouTube' <https://www.youtube.com/watch?v=8fW9HO11taA> accessed 16 February 2024.

The Pooja Bahry case essentially highlights an important concept in insolvency law. Under Section 43(2) of the Insolvency and Bankruptcy Code, 2016 the corporate debtor's purpose is not taken into consideration when determining whether a preferential transaction has occurred. The tribunal's careful reading highlights that, regardless of the debtor's true intentions, an agreement is deemed preferred provided certain requirements are satisfied. The above ratio prevents preferential arrangements from being misused by indicating the necessity for strict execution of legislative restrictions while also guaranteeing impartiality in insolvency procedures. The ruling contributes to the efficiency and integrity of the CIRP by establishing a precedent that gives precedence to the specific legal requirements above the underlying intent.