

# LOOK- BACK PERIOD VIS-A-VIS FRAUDULENT TRANSACTIONS

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**Editor's Notes:** Avoidance proceedings are a common feature in insolvency proceedings that seek to bring the assets back home – by annulling preferential, undervalued, extortionate and fraudulent transactions. When it comes to questioning the vires of such transactions, the law travels back to a particular period (which is often 1-2 years), often referred to as 'look-back period', or 'twilight zone', or 'relevant period' to determine whether such transactions contributed to the gradual downfall - as insolvency cannot be an abrupt accident. An interesting question that arises here is, whether 'fraud' has an expiry date. That is, is it possible to see beyond the 'look-back' period to undo a fraudulent transaction?

The article explores this possibility:

Sections 45, 49, 66, 69 of the Code requires and empowers the Liquidator to apply to the Adjudicating Authority for appropriate orders in case of any vulnerable transactions that the Liquidator comes across during the process of liquidation. Such transactions may either be with respect to breach of applicable law, or deleterious to the interests of creditors or stakeholders, or otherwise, not transactions designed to be in good faith. The transactions whether being undervalued or fraudulent shall be considered to be vulnerable to the interest of the stakeholders of the Company.

The article hinges on the crucial question of applicability of the limitation to the aforementioned sections. In this regard, we shall discuss how the provisions were imbibed in the Code, despite there being no equivalent in the Companies Act, 2013 or previous Companies Act. The general notion is that that limitation should be applicable to all transactions, including fraudulent transactions referred to in Section 49 of the Code. However, the article will explain as to how undervalued transaction, done deliberately without due compliances, partakes the nature of a fraudulent transaction, and since fraud is a nullity forever, in case of such transactions, as covered by Section 49, there is no question of any look- back period at all.

## **Deciphering the intent of incorporation of provisions relating to vulnerable transactions:**

The concept of "fraudulent preference" existed both in Companies Act, 1956 and 2013, however, the provision pertaining to undervalued and fraudulent transaction is a unique incorporation in the Code, adopted from the UK Insolvency Act, 1986. The Bankruptcy Law Reform Committee, referring to Section 243 of UK Insolvency Act, 1986, recommended that a provision voiding transactions defrauding creditors should be included. It is further, pertinent to note that the Committee, while discussing the intent behind insertion of this provision in the statute, observed that the provision for fraudulent transactions should not have any time- bar. The relevant extract from Interim Report (page 98-99) of the Committee is reproduced below:

## **Lookback Period vis-à-vis Fraudulent Transactions**

“In the UK, Section 423 of the IA 1986 voids transactions at undervalue if such transactions have been entered into with the intention of putting the assets beyond the reach of, or otherwise prejudicing the interests of a person who is making or may make a claim against the company. While the scope of this provision is similar to that of the provision avoiding transactions at undervalue (Section 238, IA 1986), Section 423 actions differ in that they do not have any time limit for the challenged transactions, and is available in and outside formal insolvency proceedings. The inclusion of such a provision in the CA 2013 would reinforce the protection given to creditors under avoidance law by permitting the liquidator to set aside transactions entered into prior to the one year period ending in the company’s insolvency. *This is necessary to guard against the siphoning away of corporate assets by managers who have knowledge of the company’s financial affairs in cases where a long period of financial trouble, extending over a year, ends in insolvency.*

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*A provision invalidating transactions defrauding creditors similar to Section 423 of the IA 1986 should be inserted in CA 2013. Such provision would apply without any time limits and should be available in and outside formal insolvency proceedings.*

It is clear that the analogous provision in the UK law does not have any limitation period, and also, there is no limitation period with reference to Sections 49 and 66 in the language of the law itself. Here, it is relevant to cite Report of Insolvency Law Committee (March, 2018), by virtue of which an amendment was made to exclude time limit from Section 69 of the Code:

“24.1. Section 69 of the Code provides for punishment for transactions defrauding creditors by the corporate debtor or its officers “on or after the insolvency commencement date”. However, *as per sub-section (a), if the transaction results in a gift or transfer or creation of a charge or the accused has caused or connived in execution of a decree or order against the property of the corporate debtor, the accused shall not be punishable if such act was committed five years before the insolvency commencement date or if she proves that she had not intended to defraud the creditors. In this respect, the pre-fixing of the offence with “on or after the insolvency commencement date” is erroneous.* Further, pre-fixing the same phrase in sub-section (b) is also erroneous, as the transaction involves concealment or removal of any property within two months from the date of any unsatisfied judgement or order for payment of money. *Thus, the Committee decided that the phrase “on or after the insolvency commencement date” be deleted from section 69.*”

Additionally, vulnerable transactions are generally considered to be transactions of a continuing nature, having their adverse and prejudicial impact on the ongoing financial position of the Company, which has already slipped into distress, and therefore, the concept of any look-back period or claw-back period will not be applicable, since it cannot be contended that a transaction, done with a deliberate, culpable design, becomes washed of its gullibility merely because the liquidation proceedings are initiated certain number of years after the date of commission of the relevant transaction.

**Distinction between Section 45 and Section 49:**

Both Sections 45 and 49 pertains to avoidance of undervalued transactions, the only difference being that Section 49 deals with undervalued transactions undertaken with a malafide or wrongful intent, while for Section 45, the presence of any motive is not required. The reference in section 49 to transactions covered by section 45 is merely for the factual ambit of transactions covered by the section, and the additional element of intent marks the crucial difference between the two sections.

Moreover, while a look- back period has been provided for undervalued transactions under Section 46, there is no limitation period for fraudulent transactions covered under Sections 49 and 66 of the Code. The intent being “once a fraud, always a fraud”, a time- honoured doctrine clearly applies. The maxim “*fraud vitiates every transaction into which it enters applies to judgments as well as to contracts and other transactions*” is a part of common law jurisprudence, largely based upon equitable doctrines and has been upheld by courts repeatedly in several cases such as *The People of the State of Illinois v. Fred E. Sterling*, 357 Ill. 354; 192 N.E. 229 (1934), *Allen F. Moore v. Stanley F. Sievers*, 336 Ill. 316; 168 N.E. 259 (1929), and further, *In re Village of Willowbrook*, 37 Ill.App.2d 393 (1962), wherein it was observed “It is axiomatic that fraud vitiates everything.”.

Fraud destroys the validity of everything into which it enters, and that it vitiates the most solemn contracts, documents, and even judgments, is well settled, and has been time and again reiterated in various judgments in broad and sweeping language. If both the sections were to encompass a time-limit then it would defy the whole purpose, and the reason for incorporating two separate provisions in the Code would fail. The basic essence is that any person who has done any wilful act should not be allowed to get away by citing reasons such as lapse of time.

In light of the aforesaid, it can be concluded that while an undervalued transaction is a matter of fact, for which intention does not matter, however, when the intention to cause a prejudice to the creditors is embedded in such undervalued transaction, the transaction comes within the offence of Section 49. If a transaction, so imbued with a malafide intent, was subject to the same fate and the same limitation as a transaction mentioned in Section 45, then Section 49 would not have any relevance at all. On the contrary, it can be pointed out that Section 49 was inserted specifically for the so-called willful defaulters, for which the limitation of time, mentioned in Section 45, cannot be relevant at all. Thus, it will not be correct to say that there is any claw-back for wilfully undervalued transactions under Section 49 and fraudulent conduct of business under Section 66.

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