



# **SECTION V: PREFERENTIAL, WRONGFUL & FRAUDULENT TRANSACTIONS**

## **Preferential, Wrongful & Fraudulent Transactions**

### **Editor's Note**

*Sections 43 to 51 of the Code contain provisions dealing with 4 types of transactions, which may collectively be called “vulnerable transactions”. Additionally, section 66 (1) and 66 (2) deals with the power of the Adjudicating Authority to make contribution orders in respect of fraudulent conduct of business, and wrongful conduct of business, respectively.*

*Both – the proceedings against vulnerable transactions, and proceedings for contribution orders, are meant for swelling the liquidation estate. Unlike what might appear to be the case, the intent of the RP or liquidator in initiating these proceedings is not penal – prosecution is a different aspect altogether. The clear intent of each of these proceedings is to bring back into the company or liquidation estate money/assets that may have gone beyond the reach of the company/liquidator.*

*Sections 43 to 51, and section 66 differ in their scope and purport. Sections 43 to 51 are mostly about transactions, and therefore, the remedy generally will be reversal of the impact of successfully assailed transactions. Section 66 (1) and (2) both deal with the general conduct of business – an isolated or specific transaction is not the subject matter of this section. Section 66 is, in a manner of speaking, a dent on the principle of separation of legal personality or limited liability. By virtue of section 66 (1), if the conduct of business has been fraudulent, it may lead to contribution orders against any person who is responsible for the same. The scope of section 66 (1) is not limited to directors. While this remains to be tested, but it may be felt that if the creation of holding/subsidiary layers is also a clever design, done deliberately to insulate the assets or operations of a corporate debtor, section 66 (1) may even be triggered to invoke “group liability” or “substantive consolidation” – a concept which is discussed in one of the chapters in this book.*

*Section 66 (2), as a distinct ground of challenge, is against the continuation of business by a beleaguered company, where the board of directors is clearly aware that there is no hope for revival. In such cases, the directors will be liable to make contribution for the aggravation of losses, and thereby, the depletion of assets of lenders/creditors. This also is, therefore, an exception to the principle of limited liability.*

*Both sections 66 (1) and (2) are inspired by UK Insolvency Act [sections 213 and 214 respectively], and have been inserted after strong recommendations of the Cork Committee. Both the sections do not have parallels in winding up provisions.*

*Sections 43 and 45 deal with preferential and undervalued transactions, respectively. A transaction is preferential, irrespective of being for good value. Preference is usually by preferring one over the other. That is, if someone is put to unjust advantage over others, there is a case of preference. This may be due to a payment, security, terms of borrowing, or the like. Undervalued transactions, on the other hand, result into unjust enrichment at the cost of the company.*

**Section 49 of the IBC Law**

Section 49 of the Indian law corresponds to 423 of the UK Insolvency Act. The UK provision has received very interesting comments in several UK rulings. Here is one:

“Section 423 plays an important role in insolvency law. It can moreover apply even though the debtor is not in a formal insolvency ... Section [423] is a carefully calibrated section forming part of a carefully calibrated group of sections.” [IRC v Hashmi [\[2002\] 2 BCLC 489](#)]

*Section 49, though, refers to section 45 in terms of its scope, but is not the same as section 45. The distinctive feature in section 49 is “deliberate” action. Hence, transactions deliberately entered into for keeping the assets of the company beyond the reach of creditors, or generally, to adversely affect the interests of claimants, can be assailed under this section. Section 49 is inspired by section 423 of the UK Act. The BLRC has specifically discussed wilful defaults, and has recommended*

*that the claw-back period applicable to actions under sections 43, 45 and 49, should not be applicable where there is a deliberate or fraudulent intent.*

*While the history of winding up laws in India has rich jurisprudence dealing with vulnerable transactions, the provisions of the sections cited above have mostly been inspired by UK law have almost analogous language. Therefore, there is substantial advantage in learning from the case law under the UK law under the corresponding provisions.*