Unmasking the Asset tracing tools under the Indian Insolvency Laws

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"Asset tracing" is not a novel concept. This practice has been in existence since ages. It attaches itself with the phenomenon of lending as well as varied forms of transfer of property – such as by creation of a trust, bailment, pledging, mortgaging or sale of the property. It has an intriguing convergence with the insolvency laws. As the legal framework pertaining to insolvency has recently been overhauled in India, the author wishes to indulge in a detailed and metamorphic analysis of the divergent roads towards asset tracing in primarily three jurisdictions: - United States, United Kingdom and India.

Testing the Waters for Asset tracing

Since ages, credit has been playing a significant role in the effective and efficient operations of any economy[1] as it enables the goods and services to be traded on a much broader level than otherwise would be the case. "Credit" is derived from a Latin term 'credere' which essentially implies the confidence and trust reposed by the lender in the debtor[2]. However, in the modern day corporate scenario, it is imperative that the risks assumed by the lender while financing are reduced to a negligible extent[3]. Such risk reduction is normally effected by importing terms and conditions relating to security and guarantee in the lending agreement[4].

Moreover, in this backdrop it is condign to appreciate that for almost as long as there have been credit transactions and dealings there have been debtor who have been unable to fulfil their debt obligations either due to uncontrollable factors, mismanagement or deviousness. In such a dilemma, triggering of the collective nature of the insolvency procedures against the debtor assumes utmost importance. The procedures for insolvency resolution and bankruptcy are collective in nature so as to ensure that the assets owned by the debtor are distributed amongst the creditors in the fairest manner possible in a given scenario[5].

The statutory obligation of the insolvent entity to consign its assets for distribution to the creditors coupled with the inability of those assets to sufficiently address the claims has often led to a varied range of pursuits by the insolvent entity to escape the legal shackles of distribution. It consequently attempts to carve out the most efficient route for its asset employment[6]. As a noticeable trend, the assets of the company may be dissipated through gifts or transactions for which the company does not get full value[7]. This may capacitate a "phoenix company" to rise from the ashes with a similar

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1 Gail Pierson, "The Role of Money in Economic Growth" (1972) 86(3) The Quarterly Journal of Economics.

2 Charles A. Conant, "The Development of Credit" (1899) 7(2) Journal of Political Economy.

3 Rowena Olegario, *A Culture of Credit: Embedding Trust and Transparency in American Business* (2006).

4 D. Levhari and D. Patinkin, "The Role of Money in a Simple Growth Model" (1968) 45 American Economic Review.

5 V.S. Datey, *Taxmann's Guide to Insolvency and Bankruptcy Code* (7th edn., 2019).

6 Rebecca Parry et al., *Transaction Avoidance in Insolvencies* (3rd edn., OUP 2018) 3; *Sykes Butchers Ltd., In re* 1998 BCC 484:— It encapsulates the incentives for the directors of the insolvent entity to repay the bank overdraft for which they have personally guaranteed prior to the distribution of the assets of such entity to avoid any personal attribution of liability.

7 *Continental Assurance Co. of London Plc., In re*, (1997) 1 BCLC 48; *Brian D. Pierson (Contractors) Ltd., In re*, 1999 BCC 26.

business but it contradicts the ground objective of protecting the creditors of the insolvent entity[8].

The legislative problem to the above discussed issue has been to expressly encompass specific provisions which enable the avoidance of such abusive transactions[9]. These legal fetters are tabled to enable the entity in the management and control of the assets of the debtor to avoid certain agreements which showcase preferential behaviour of the debtor to excessively guard the investments of certain creditors. Additionally, it also enshrouds the transactions wherein certain creditors highlight the insufficiency of debtor's assets by claiming security on extortionate terms to procure an undue advantage over other creditors.

In this context, the revelation and optimum conservancy of concealed assets (which may also be termed as '**fructus sceleri**' or the '**fruits of fraud**') allied to debtor's estate turns into a focal point for any insolvency office-holder. The rate of recovery of these assets and the accumulated costs for the same have also been analyzed as factors to initiate the process of asset tracing (the cost-benefit analysis of the entire process). Moreover, there are various other considerations for the party contemplating to initiate and conduct the process of asset tracing[10]. Whilst the author would have desired to address all the concerns identified in this respect, the limited scope of this article only allows a high level analysis of a few select issues.

ASSET TRACING IN UNITED STATES – THE TRINITARIAN CONTRIVANCE

This section of the Article critically examines the key elements which exist in the US Bankruptcy regime for the effective redressal of the issues concerning asset concealment. As has been succinctly observed, asset concealment has a contagion effect which undermines the trust and confidence in the

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8 Neil Hannan, *Cross-Border Insolvency* (1st edn., 2017).

9 D. Brown and T.G.W. Telfer, "The 'New Australasian' Voidable Preference Law: Plus Ca Change?", (2007) 13 New Zealand Business Law Quarterly 160; J.S.U. Bodoff, "Bankruptcy Reform Study Project: The ABI Performance Survey" (1997); A. Duggan and T. Tefler, "Canadian Preference Law Reform" (2006-07) 42 Texas International Law Journal 661; I. Fletcher, "Voidable Transactions in Bankruptcy: British Law Perspectives", as cited in J. Ziegel, *Current Developments in International and Comparative Corporate Insolvency Law*, (Oxford University Press 1994); R. Goode, *Principles of Corporate Insolvency Law* (4th edn., 2011).

10 For example: "The Existence and Impact of a Commercial Crime Insurance Policy"; Nathan Wadlinger, et al., "Domestic Asset Tracing and Recovery of Hidden Assets and the Spoils of Financial Crime", (2018) 49 St. Mary's Law Journal 609, 614.

capital markets and consequently shakes the well-being of the entire world economy[11]. The triggering of the Bankruptcy process under the U.S. Laws has twin-fold ramifications. Firstly, it leads to the crystallization of the bankruptcy estate[12]. Although the Congress intended to delineate the broadest possible amplification of the estate, it is apposite to observe that the estate only succeeds to limited rights which are possessed by the debtor and no greater interests in that property[13].

The legal apparatus for asset recovery in the United States can be examined in three forms:

(A) **Operation of automatic stay**[14] on the initiation of a novel litigation, enforcement of a judgment or a lien against the debtor, recovery of any pre-petition claim against the debtor etc. It aims to guard the bankruptcy estate from disintegrating.

(B) **Preference and Fraudulent transfer avoidance actions** which facilitate the estate succession to whole of the assets of the debtor and endorses the obliteration from the resultant contractual obligations.

(C) **Discovery** powers of the bankruptcy participants to unearth the whereabouts of the hidden assets.

Trustees and debtors-in-possession (as the United States' Bankruptcy Law endorses allegiance to the Debtor-in-possession model of insolvency resolution[15]) have been adequately empowered under the U.S. Bankruptcy Code to facilitate the recovery of assets for the well-being of the creditors. A detailed analysis of the above outlined three legal mechanisms is indispensable to appropriately appreciate the asset tracing framework under the U.S. Bankruptcy laws. As a cherry on the cake, the potential criminal liabilities

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11 Martin S. Kenney, "Serious Fraud" in Bernd H. Klose (ed.) *Asset Tracing & Recovery: The Fraudnet World Compendium* 19, (2009).

12 The "property of the estate" is defined as inclusive of all legal and equitable interests of the company: 11 USC § 541(*a*)(1).

13 11 USC § 541(*d*) narrates: —"*Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest, such as a mortgage secured by real property, or an interest in such a mortgage, sold by the debtor but as to which the debtor retains legal title to service or supervise the servicing of such mortgage or interest, becomes property of the estate under sub-section (a)(1) or (2) of this section only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.*"; further illustrated in Felicity Toube (ed.), *International Asset Tracing in Insolvency* (77, 2009).

14 11 USC § 362(*a*).

15 Baker McKenzie, Global Restructuring & Insolvency Guide, <http://restructuring.Bakermckenzie.com/wp-content/uploads/sites/23/2016/12/Global-Restructuring-Insolvency-Guide-New-Logo-United-States.pdf> accessed March 20 2019; Gerard McCormack, "Control and Corporate Rescue — An Anglo-American Evaluation", (2007) 56 Int'l & Comp. L.Q. 515.

and the risks of equitable subordination or re-characterization of the claims of the creditors ensures that the whole exercise augments the betterment of the creditors.

Cushioning the bankruptcy estate – The Automatic Stay

The initiation of a Bankruptcy proceeding leads to the creation of an automatic stay[16]. It operates analogous to an injunction for the creditors from resorting to any judicial or private means for enforcement of their rights against the estate except via the prescribed procedures under the Bankruptcy Code[17]. In this manner, it fulfills twin objectives – Firstly, it cushions the estate from any pre-petition claim and secondly it benefits the entire class of creditors by assuring an orderly distribution of estate and avoids the race to other authorities.

Notably, despite the wider breadth of the stay, it excludes suits against debtor's guarantors or corporate affiliates[18], shareholders[19], partners (only when they, in their individual capacity, have not been subjected to Bankruptcy[20]). However, notwithstanding these exceptions to the automatic stay, the bankruptcy court has been empowered to enjoin any actions when their independent assessment would lead to the development of hurdles in the debtor's capacity to re-organize[21].

The safe harbor provisions in respect of the operation of automatic stay are provided in section 362(b) of the code. It contains 28 exceptions in its entirety. One of the pertinent exceptions among them is crucial to be analyzed. This exception is designed to permit a non-debtor party to close-out the derivative contracts notwithstanding the automatic stay.

The raison d'être for exempting these contracts from the applicability of the automatic stay is to prevent any resultant impairment of the liquidity of the concerned underlying agreement and of the counter-party. Such concerns have been acknowledged to be extremely prescient[22] in the context of the devastating effect of the bankruptcy of Lehman Brothers Holdings Inc. In that scenario, the counterparties were permitted to enter into agreements

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16 11 USC § 362(*a*); *Credit Alliance Corpn.* v. *Garry L. Williams*, 851 F 2d 119 (4th Cir 1988).

17 *Patterson* v. *Shumate*, 1992 SCC OnLine US SC 74 : 119 L Ed 2d 519 : 504 US 753 (1992).

18 *Otoe County National Bank* v. *W & P Trucking Inc.*, 754 F 2d 881 (10th Cir 1985).

19 *Spaulding Composites Co. Inc., In re*, 207 BR 899 (1997).

20 *Patton* v. *Bearden*, 8 F 3d 343 (6th Cir 1993).

21 *Wedgeworth* v. *Fibreboard Corpn. Fontenot,* 706 F 2d 541 (5th Cir 1983).

22 Felicity Toube (ed.), *International Asset Tracing in Insolvency* (2009).

with other entities which would fully or partially offset any over-the-counter derivatives existing with the Lehman Brothers.

The amendments floated in 2005 to the Bankruptcy Code further reinforced varied safe harbor protections. It significantly expanded the definition of "re-purchase agreements" by including mortgage related securities, mortgage loans and interests in mortgage securities[23]. It also created a space for cross-product netting under a "master netting agreement"[24].

If the automatic stay imposed as per the legal framework as discussed is violated, the courts have held the actions to be void[25] or voidable at the option of the debtor[26]. The effect of this nullification of the action of the creditor is to convert the secured creditors' claim into an unsecured claim. When the stay is knowingly breached by any of the party, the court may punish that party for contempt because an automatic stay is treated to be equivalent to a court order[27].

Avoidance Actions – Invalidating the "transfers" and restoration to the "original position"

The U.S. Bankruptcy Code consists of a double set of avoiding powers consisting of fraudulent conveyances (section 548) and unlawful preferences (section 547). The Avoidance Powers (also termed as "**claw back actions**") are mechanisms for recovery of the property of the debtor when the circumstances shrouding the transactions fall within the element prescribed by the relevant statute[28]. It is extremely pertinent to comprehend the benefits reaped by enforcing these powers with the managing trustee or the debtor in possession.

The prominent advantage is the ex-ante amelioration or ex-post reversal of opportunistic, value destructive attitudes (which includes but is not limited to asset dilution, asset substitution, debt dilution) potentially encountered by bankrupt debtor entities[29]. Hence, it ensures maximization of the value of the firm as it demotivates the market players to conclusively enter into agreements with a bankrupt entity.

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23 11 USC § 101(47) (2009).

24 *Ibid.*, § 561 (2009).

25 *Soares* v. *Brockton Credit Union*, 107 F 3d 969 (1st Cir 1997).

26 *Jones* v. *A. Garcia*, 63 F 3d 411 (5th Cir 1995).

27 *Vahlsing* v. *Commercial Union Insurance Co. Inc.*, 928 F 2d 486 (1st Cir 1991).

28 Robert Clark, "The Duties of the Corporate Debtor to its Creditors" (1977) 90 Harvard Law Review 505.

29 Aurelio Gurrea-Martínez, "The Avoidance of Pre-Bankruptcy Transactions: An Economic and Comparative Approach", (2018) 93 Chicago-Kent Law Review.

Additionally, it also prevents the invigorated rat race to debtor's assets when bankruptcy is predicted and resultantly abridges the "common pool"[30] concern of the Bankruptcy Law. The "common pool" (as applied within this framework) indicates the scarce assets of the Bankrupt entities which is essentially mandated to be collectively managed to avoid the narrative of "tragedy of the commons"[31]. This necessitates a collective and coordinated decision making[32].

The retrospective implication of the "avoidance powers" for validly executed transactions may prove to be disastrous for the want of legal certainty and clarity. Therefore, the legal design for avoidance transactions shall harmonize the concerns of the common pool objective and the bona fide investment by the non-bankrupt counterparty to the contested transactions. One of the routes to achieve this is to statutorily prescribe a time period for the transactions to be scrutinized under the avoidance powers of the trustee (which is commonly referred to as the "twilight period", "suspect period", and "look-back period").

The "**Twilight Period**" – Minimizing the risk of ambivalence vis-à-vis Counterparty's investment

Twilight zone or period has not been statutorily explicated, however, in common terms, this period is accredited as the maximum period antecedent to the initiation of the Bankruptcy procedure whose transactions can be assailed and put to scrutiny pursuant to avoidance powers[33]. It implies the time duration between the realization of absence of any prospects of avoiding the "trigger event" for bankruptcy and its real initiation[34].

While deciding the duration of this period, several policy considerations are required to be analyzed in detail. A very long period might inflate the value of the estate but it will not be enabled to eliminate the costs affiliated with legal uncertainty. On the contrary, a shorter period may lead to predictability but will surely erode the underlying design of the avoidance powers. The decision in relation to this period may also digress due to the

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30 Agasha Mugasha, "Solutions for Developing-Country External Debt: Insolvency of Forgiveness", (2007) 13 Law and Business Review of the Americas 859.

31 Garrett Hardin, "The Tragedy of the Commons", (1968) 162 Science 1243.

32 Jodie A. Kirshner, "Design Flaws in the Bankruptcy Regime: Lessons from the UK for Preventing a Resurgent Creditors' Race in the U.S.", <https://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=1482&context=jbl> accessed 20 April, 2018.

33 Douglas Baird and Robert K. Rasmussen, "Chapter 11 at Twilight", (2003) 56 Stanford Law Review 673; *Grafton Partners, In re,* 321 BR 527 (2005); Dennis Faber, *Commencement of Insolvency Proceedings* [Niels Vermunt , Jason Kilborn, Tomas Richter, (eds.), 2012].

34 D. Milman, "Strategies for Regulating Managerial Performance in the 'Twilight Zone' – Familiar Dilemmas: New Considerations", (2004) 4 Journal of Business Law 493.

nature of the concerned transaction or the counterparty[35]. Furthermore, the imposition of certain temporal limits within these avoidance powers in the bounds of the legal procedure might also facilitate to avoid any haziness in the administration of the Bankruptcy procedure to debtors.

Preferential transactions – An ex-ante tool for asset tracing

The avoidance of preferential transactions is addressed under Section 547 of the Bankruptcy Code. Sub-section (b) envelops five stipulations for testing the transfer of debtor's property on the touchstone of avoidance powers[36]. Firstly, the transfer must be to or for the benefit of the creditor. Secondly, it shall account for an antecedent debt owed by the bankrupt entity. Thirdly, the transfer shall be effected by the debtor while it is insolvent. Fourthly, the transfer shall have been effectuated during 90 days preceding the onset of the bankruptcy case, or if the transfer is made to an insider[37], during the period beginning one year prior to initiation of bankruptcy and ending 90 days before the filing of bankruptcy (further, it is to be noted that the condition precedent for the elongated twilight period to apply attaches itself to the factum of the existence of a reasonable cause with the insider to believe that the debtor was insolvent at the time of the agreement[38]). Fifthly and lastly, such transfer shall have elevated the circumstances of the counterparty in comparison to its position under the Bankruptcy Code.

Moreover, this rigid statutory design for avoidance of preferential transactions may have an adverse effect on the willingness to deal with entities encountering financial difficulties[39]. To address this concern, and to reduce the risk of potential disgorgement of payments received for value by the counterparties, the Bankruptcy Code also enumerates certain exceptions.

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35 For instance, the period is longer for the related parties as counterparties as they are expected to be well-apprised of the circumstances of the debtor while shorter for the non-related parties.

36 11 USC § 547(*b*) (2009).

37 An "insider" has been marked as having sufficiently close relationship with the debtor and therefore are mandatorily subjected to stricter scrutiny and checks; S Rep No. 95-989, at 25 (1978).

38 *Holloway Browning Interests* v. *W. Allisonl*, 955 F 2d 1008 (1992); It has also been held that any transfer made to a non-insider that benefits the insiders shall be tested on the touchstones of the reach-back period as prescribed for the insiders and not non-insiders – *Levit Vn* v. *Ingersoll Rand Financial Corpn.*, 874 F 2d 1186 (7th Cir 1989).

39 *Jones Truck Lines Inc.* v. *Central States, Southeast and Southwest Areas Pension Fund*, 130 F 3d 323 (8th Cir 1997).

It excludes contemporaneous exchanges[40] as it is not on account of an antecedent debt in its real sense[41]. However, to ensure that this exception does not become the escape route to allow preferential transactions, its applicability has been limited to only those cases wherein no action has been effectuated by the counterparty-creditor (such as demanding security etc.) on being apprised of the lack of requisite intent of the debtor to pay for the value/or about its factual insolvent state of affairs[42].

Secondly, to ensure that when an entity slides into bankruptcy, its normal operations are not impaired and it continues as a going concern with the hope to resume and resolve sooner or later, section 547(c) also drives out the transactions materialized in the ordinary course of business[43].

Thirdly, the Code also nets out transactions leading to the creation of new security interest for new value pursuant to a valid security agreement to empower the debtor to acquire the property[44] (also termed as the "new value defense") It is imperative that it is perfected on or before the expiry of 30 days post receipt of possession by the debtor.

The creditor must corroborate that (a) the new value is bequeathed post preferential transfer, (b) the "new value" is of an unsecured nature, and (c) the "new value" remains unpaid[45]. A lion's share in the U.S. judicial system believes that even if the new value is paid with the alleged transaction[46] , it will qualify as "new value".[47]

Judicial shield accorded to Earmarked Secured Loans

Adjoining the statutorily prescribed exceptions to avoidance of preferential agreements, the U.S. Judiciary has also espoused the doctrine of "Earmarking". This doctrine propagates that if a third party has advanced a loan to the bankrupt debtor entity to pay off a specific creditor, it cannot be frowned upon by the trustee as a preferential transaction[48]. This doctrine derives its prominence from the fact that the debtor never had actual control

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40 11 USC § 547(*c*)(1) (2009).
41 HR Rep No. 95-595 (1977).
42 *National City Bank of New York* v. *Henry D. Hotchkiss*, 1913 SCC OnLine US SC 254 : 58 L Ed 115 : 231 US 50 (1913).
43 11 USC § 547(*c*)(2) (2009).
44 11 USC § 547(*c*)(3) (2009).
45 *IRFM Inc.* v. *Ever-Fresh Food Co.*, 52 F 3d 228 (9th Cir 1995).
46 The transfer of debtor's assets which is being tested for preferential avoidance.
47 *Toyota of Jefferson Inc.* v. *Vallette*, 14 F 3d 1088 (1994); *Jones Truck Lines Inc.* v. *Central States, Southeast and Southwest Areas Pension Fund*, 130 F 3d 323 (8th Cir 1997); *Check Reporting Services, Inc., In re*, 140 BR 425 (1992).
48 *Bohlen Enterprises Ltd.* v. *National Bank of Waterloo*, 859 F 2d 561 (1988).

over the funds lent by the third party and further, the payment of the same to the creditor does not tear down the bankruptcy estate[49].

Although this principle was applicable primitively when a guarantor discharged his obligations under a contract of guarantee, it was extended to any third party as well due to the same objective[50]. It is also crucial to note that the doctrine is applicable when a security interest is created on the assets of the debtor for payment of another secured loan and not unsecured debt[51].

Fraudulent transfers running afoul of the Pari-Passu rule

Section 544 and 548 of the Bankruptcy Code largely embodies the legal framework for fraudulent transfers. Section 548 enshrines the elements of a fraudulent transfer while section 544 is the strong arm clause which encapsulates the special powers of the trustee to avoid any transaction which is avoidable under the state fraudulent conveyance laws[52]. The point of difference arises when the expiry of the twilight period acts as a hurdle for the trustee to effectively enforce its powers of avoidance[53]. Fraud is type casted as Actual Fraud (defined as a transfer of an interest in the property made by the debtor within two years of bankruptcy commencement) with an actual intent of hindering, delaying or defrauding the other creditors[54]) and Constructive Fraud (wherein the insolvent debtor has received less than a reasonably equivalent value effecting to under-capitalize the debtor[55]).

The aim and objective of these provisions is to generally cushion all the creditors from the adverse impact of those transactions which impair their right to payment or which deplete the estate or maximize the obligations of the debtor. It is validated further by the application of the principle of equitable subordination (which allows one person's claim to be subordinated to its class of claims in the interests of substantial justice[56]).

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49 *Bruening* v. *M. Fulkerson*, 113 F 3d 838 (8th Cir 1997); *Kemp Pacific Fisheries Inc.* v. *MacDonald Meat Co.*, 16 F 3d 313 (9th Cir 1994).

50 *Kemp Pacific Fisheries Inc.* v. *MacDonald Meat Co.*, 16 F 3d 313 (9th Cir 1994).

51 *Muncrief* v. *Mt Prospect State Bank*, 900 F 2d 1220 (8th Cir 1990).

52 Uniform Fraudulent Conveyance Act, 1918 and Uniform Fraudulent Transfer Act, 1984.

53 For Instance — New York Civil Practice Law and Rules provides for a longer reach back period of six years than the two year period prescribed under S. 548 of the Bankruptcy Code.

54 11 USC § 548 (2009).

55 11 USC § 548 (*a*)(1) (2009).

56 *Pepper* v. *Litton*, 1939 SCC OnLine US SC 146 : 84 L Ed 281 : 308 US 295 (1939).

"Discovery" as a means to uncover the concealed assets

Amidst the mechanisms explored above for asset tracing, the discovery and the conservation of concealed assets assumes utmost prominence. "Discovery" has been agreed to be an iterative process[57] pursuant to which the creditors or any other interested parties can access material information in relation to the whereabouts and value of the debtor's assets.

The Federal Rules of Bankruptcy Procedure (FRBP) ('Bankruptcy Rule 2004') are the primitive means for discovery as they expedite the process and insist upon the preservation of confidential information[58]. The rule leads the interested party to knock on court's doors to order the examination of any entity. The nature of information in a case Chapter 11 may, inter alia, include any matter which is material to the formulation of a plan. The bounds of this Rules are wider in comparison to the Federal Rules of Civil Procedure as in these Rules, the party seeking information need not provide exact details about it (it is symmetrical to a fishing expedition[59]). However to ensure that the interests of the creditors and the debtor are attuned, the Rules also stipulate that the party seeking the motion shall also depict sufficient cause[60].

The Burgeoning effect of Bankruptcy Rule 2004 – Issuance of Subpoenas

The Bankruptcy Rule of 2004 is only curtailed to legalize debtor's investigation and it unmistakably recapitulates that a subpoena is not prescribed for debtor to honor the order of the court[61]. Moreover, for securing the attendance of a non-debtor party, issuance of subpoenas gains prominence. Therefore, the Bankruptcy Rule 2004 ascribes to Bankruptcy Rule 9016 and the Federal Rules of Civil Procedure. They govern the variety of unfolds of obtaining and issuing subpoenas for three-pronged objective:- To secure attendance of a person, to produce documents and to permit the inspection of the property.

For the purposes of safeguarding the interests of the witness, and to ensure that the creditor/issuing party does not inflict unjust hardships or expenses on the witnesses, they are warranted for the mileage costs and witness' fees

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57 Phyllis Atkinson, *Introduction*, as cited in *Tracing Stolen Assets: A Practitioner's Handbook* 19 (2009) (it also approximates the frequency at which criminal moneys are traded through financial centers to escape tracing by the law enforcement agencies).

58 Federal Rules of Bankruptcy Procedure 2004(*a*) (2009).

59 *Duratech Industries, Inc., In re*, 241 BR 283 (EDNY 1999).

60 *Bennett Funding Group, Inc. In re,* 203 BR 24 (Bankr. NDNY 1996).

61 Federal Rules of Bankruptcy Procedure 2004(*d*) (2009).

for one day[62]. It is an instance of the assurance that these discovery mechanisms are not intended to veil collusive activities among the creditors.

The Tracing Formulas

The Low Intermediate Balance Test (LIBT) formula states that if any payments are made from the commingled funds, it is presumed to have been made from the unencumbered part of the funds[63]. Under this rule, the funds are guarded only to the bounds of the lowest balance in the commingled account[64]. The First-In First-Out (FIFO) rule which formerly played a remarkable role in inventory valuation, generates the assumption that any funds wrongfully diverted into an account shortly preceding the bankruptcy survives in that account until the originally deposited funds of that account are employed[65]. This rule further fortifies the legislative intent to avoid any eleventh hour transfers of funds and then prodigalize them to the benefit of certain creditors. Conversely, the Last-In First-Out (LIFO) rule postulates that lately added funds are to be subtracted at the first instance[66]. However, the court is also capacitated to impose "reasonable assumptions doctrine" where an inapposite outcome is delivered due to the application of these rules[67].

ASSET TRACING IN UNITED KINGDOM:- FORTIFYING THE SUBSTANTIAL COLLECTIVITY

The prime beneficiary in the insolvency proceeding shall be the general body of creditors. The Cork Committee discouraged the provision of separate remedies to the creditors and emphasized a consistent and collective redressal of their grievances arising out of a common disaster[68]. This section of the Article scrutinizes the English law for asset-tracing and the orders which may be given by an English court to further the recovery of assets of the bankrupt company. It primarily focuses on the doctrine of creation of

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62 Federal Rules of Civil Procedure 45(*c*)(3) (2009).

63 *Mahan & Rowsey Inc.*, *In re*, 817 F 2d 682 (10th Cir 1987).

64 Jean-Pierre Brun, et al., *Asset Recovery Handbook: A Guide for Practitioners* (2011).

65 *California Trade Technical Schools Inc.* v. *United States of America*, 923 F 2d 641 (9th Cir 1991).

66 *Chase Manhattan Bank* v. *Traditional Investment Corpn.*, 92 Civ 2774 (1995).

67 *Begier* v. *Internal Revenue Service*, 1990 SCC OnLine US SC 96 : 110 L Ed 2d 46 : 496 US 53 (1990) – The tracing rules were found to be inapplicable for the payment of taxes to the IRS; *Megafoods Stores Inc.*, *In re*,163 F 3d 1063 (9th Cir 1998) – The court applied LIBT rule to trace tax funds in a commingled account.

68 Report of the Review Committee on Insolvency Law and Practice (Cm 8558, 1982) 232.

constructive trusts, piercing of the corporate veil, sham, civil and criminal orders along with the requisite disclosures.

An office holder will be entitled to acquire and manage the "property" of the company. Although lacking a precise definition the term ''property'' has been characterized in section 436 of the Insolvency Act, 1986 to be inclusive of money, goods, things in action, land and every description of property wherever situated and obligations and every description of interest, whether present, future, vested or contingent arising out of or incidental to the property[69].

Moratorium imposition – The most powerful tool

One of the significant tools in the arsenal of the office holder is the imposition of moratorium as against any action of proceeding against the company or its property[70]. It resultantly forestalls any individual creditor actions and halts the invigorated race to the assets of the company. Hence, it amounts to the provision of a "breathing space" to arrive at a comprehensive reorganization plan.

This statutory framework further reflects cognizance of the "absolute priority rule" (which connotes an equal treatment to the creditors of the same priority class and according hierarchies to the existing creditors)[71]. On the same lines, it is apposite to acknowledge that the secured creditors have been bestowed with the right to petition for lifting the moratorium against individual creditor actions and then seek allegiance to the assets of the company having security interest[72]provided that the claimant may prove that lifting of the moratorium is not prejudicial to the process of insolvency resolution and on the contrary if the moratorium is not lifted it will prejudice the interests of the claimant[73].

Misfeasance claims against the office holder

Section 212 of the Insolvency Act, 1986 provides for the remedy in cases of misapplication, retention of the money or any other property of the

[69] Insolvency Act, 1986, S. 436.

[70] Insolvency Act,1986, S. 130.

[71] Insolvency Act, 1986, Ss. 40 and 175.

[72] *Insolvency Act, 1986*, c.45, Sch. B1; Abeyratne et al., "Corporate Rescues — A Comparative Study of the Law and Procedure in Australia, Canada and England", (DPhil thesis, University of London 1995); Alan Meek and John Reid, "UK: Lifting the Moratorium in Administration" <http://www.mondaq.com/ uk/x/208956/Insolvency+Bankruptcy/Lifting+The+Moratorium+In+Administration> accessed 20 April 2018.

[73] *Lazari GP Ltd.* v. *Jervis*, 2012 EWHC 1466 (Ch).

company[74] by the incumbent or previous 'officers'[75] of the company or a person who has acted as the receiver, liquidator or administrative receiver of the company[76] or any other person who has been concerned in the promotion, formation and management of the company[77]. Thereafter it also extends its applicability to any act of 'misfeasance' or breach of any fiduciary duty **in relation to the company.**

The England and Wales Court of Appeal, as late as in 2003, ruled in this context. Oldham v. Kyrris[78] was a dispute concerning the administration procedure of Mr. Jack Kyrris' partnership wherein Mr. Michael Oldham was given charge as an administrator. The dispute was initiated by one Mario Royle (employee) seeking remedies against Mr. Oldham for breach of duty of care. The claim was vehemently denied by the court. The court endorsed a strong reference to Section 212 of the Insolvency Act, 1986 and drew an inference that the administrator, liquidator, voluntary liquidator or receiver ("insolvency officials") owes no direct duty of care to the creditors, absent any special factual relationship. Such duties are solely directed and owed to the concerned company.

In this context, the immediate concern shall be to identify various possible ways to develop these "**special relationships**" with the administrator/liquidator of the company. These potential probabilities were discussed in brief in a recently decided matter by the Chancery Division of the England and Wales High Court[79]. The court, in para 63, held that if any claimant desires to seek special guards for themselves from the insolvency officials, they shall request for undertakings or specific assurances from such officials. In this case, the court placed heavy reliance on the ratio laid down by Honorable Lord Justice Sir Jonathan Frederic Parker in the Oldham's case. It held that as there were no specific representations made by the joint administrators which had been relied upon by the claimants, or specific reference to the fact that he will re-direct his efforts in any other way than as the administrator, the claim of misfeasance under section 212 cannot be sustained.

Public Examinations, Subpoenas and Restraint Orders

Section 133 of the Insolvency Act, 1986 bestows enormous authority to the court to order public examinations at the behest of the Official Receiver for

74 Insolvency Act, 1986, S. 212(1).
75 Insolvency Act, 1986, S. 212(1)(*a*).
76 Insolvency Act, 1986, S. 212(1)(*b*).
77 Insolvency Act, 1986, S. 212(1)(*c*).
78 *Oldham* v. *Kyrris*, 2003 EWCA Civ 1506.
79 *Fraser Turner Ltd*. v. *PricewaterhouseCoopers LLP*, 2018 EWHC 1743 (Ch).

any incumbent or past officer of the company, any person concerned with the promotion, formation or management of the company or for anyone who has functioned as Liquidator, administrator or receiver for the company.

An office holder may also apply to the court to order the furnishing of any property or records to which the company "appears to be entitled"[80]. Whenever any property or asset is acquired by or is devolved upon the bankrupt, it is notifiable to the trustee or the office holder[81]. To further add to the fuel, the law has attached no liability with the office holder for any wrongful seizure or disposal of asset (unless it is on account of negligent actions or omissions).

These orders are not vitiated by the rules against self-incrimination[82], however, this information cannot be put to use in any criminal proceedings at a later point of time[83]. If the bankrupt is not willing to cooperate, then there are other remedies as well such as the issuance of orders for private examinations, redirection of post etc.

Constructive Trust- Static or circumstantial?

Constructive trust is a concept which replicates the creation of security interest in an asset, with the only difference that it emerges by legal operation wherein it is not conscionable for a person to deny other's beneficial interest[84]. The courts generally assign proprietary remedies for restoration of the property or assets wrongfully deprived by the claimant or unjustly acquired by the defendant.

It includes instances of recession or avoidance of contracts due to fraudulent misrepresentation[85], payments effected under a mistake irrespective of the knowledge or negligence on the part of the person who made such mistaken payment[86], and breach of fiduciary duties (when the fiduciary is insolvent the court deems it fit to grant proprietary claims over the profits earned by the fiduciary in breach of its duties)[87].

The noteworthy facet of this asset tracing tool is two pronged – firstly, the relevance associated with the circumstances of each case. There is no general

80 *London Iron and Steel Co. Ltd., In re,* 1990 BCC 159.
81 *Insolvency Act, 1986*, S. 333(2).
82 *Bishopsgate Investment Management Ltd.* v. *Homan*, 1993 Ch 1.
83 *Suanders* v. *United Kingdom,* 1997 BCC 872.
84 *Paragon Finance Plc* v. *D.B. Thakerar & Co.*, (1999) 1 All ER 400.
85 *Banque Belge Pour L'etranger* v. *Hambrouck*, (1921) 1 KB 321.
86 *Chase Manhattan Bank NA* v. *Israel-British Bank (London) Ltd.*, 1981 Ch 105.
87 *Bristol & West Building Society* v. *Mothew*, 1998 Ch 1: (1997) 2 WLR 436.

classification of unconscionable conduct which escorts the imposition of constructive trust. Secondly, the judicial disbelief in allowing the imposition of a remedial constructive trust over a property or asset of the insolvent company[88]. These trusts are different from institutional constructive trusts as remedial trusts totally lie within the equitable discretion of the courts and do not operate by law, unlike institutional trusts[89]. The reasoning of the courts has consistently been stationed on the doctrine of separation of powers as it results in varying the proprietary rights of the parties and an Act of Parliament is required for the same[90].

Durant International Case – Turning the tables towards "Backward Tracing"

Tracing has been catalogued as a **process** of identifying the location of the property and justifying one's claim over that property[91]. As opposed to the general connotation of tracing, i.e. when a substitute asset ('traced asset') has been attained by employing the assets from the estate ("**trust asset**" when a constructive trust has been imposed over such assets by the court), backward tracing is the process which is applied when a debt is taken in exchange of an asset (traced asset) and thereupon, the trust assets are used to discharge that debt[92].

The point of difference is associated with the acquisition of the traced asset pre-misappropriation of the trust assets in backward tracing cases. As in United Kingdom, one of the major purposes of asset tracing is the identification of the property of the estate. Backward tracing has been denied in the obiter observations[93] and since then lacking a formal recognition in law, it has been lying in obscurity.

The inclination of the judicial authorities to disallow claims based on backward tracing was substantially diluted by the Durant International judgment delivered by the Privy Council in 2015[94]. This case involved pay-

88 *Polly Peck International Plc* v. *The Marangos Hotel Co. Ltd.*, 1998 EWCA Civ 789 : (1998) 3 All ER 812 and *Foskett* v. *McKeown*, (2001) 1 AC 102 : 2000 UKHL 29.

89 Michael Fiddy, "Fighting the Flab: UK Supreme Court Seeks to Limit the Scope for Remedial Constructive Trusts", <https://www.dlapiper.com/sv/uk/insights/publications/2016/11/global-insight-18/fighting-the-flab/> accessed 21 April 2018.

90 *Westdeutsche Landesbank Girozentrale* v. *Islington London Borough Council*, 1996 AC 669 : (1996) 2 WLR 802.

91 *Foskett* v. *McKeown*, (2001) 1 AC 102 : 2000 UKHL 29.

92 Alexandra Clarke, "The Future after Durant: Is Backwards Tracing the Way Forward?" 91 Oxford University Journal <https://www.law.ox.ac.uk/sites/files/oxlaw/field/field_document/7_0.pdf> accessed 25 April 2018.

93 *Bishopsgate Investment Management Ltd.* v. *Homan*, 1995 Ch 211, 221.

94 *Federal Republic of Brazil* v. *Durant International Corpn.*, 2016 AC 297 : 2015 UKPC 35.

ment of bribe proceeds in installments and the proceedings revolved around the issue-whether three of such installments can be labelled as "traced assets/ substitute assets". The chronological orientation suggested it possible only by the application of backward tracing[95] which does not have a sound application in this jurisdiction.

The council despite agreeing to the conceptual coherence and soundness of this argument[96], refuted the same, dismissed the appeal and projected the application of the test of **co-ordination between the depletion of the trust fund and acquisition of the traced asset**[97]. The Board did not doubt the correctness of the previously decided judgments[98] wherein backward or equitable tracing was held to be undeveloped for a full-fledged application. These cases were distinguished as in none of these factual scenarios was there a concerted and coordinated effect of inward and outward movement of the assets in the overall transaction.

Insolvency Specific Court orders (Civil)

If there exists a course of action justifiable in England and a prima facie case on merits coupled with the "real risk" that the defendant will attempt to dissipate the assets, the court will grant a freezing order against the assets of the defendant. These orders can also bite any third party if in that party's name, the defendant is holding beneficial assets (regardless of any specific claim against that third party)[99]. If the third party is foreign based, the order, by the application of **"Babnaft proviso"** will not be applicable unless it is given effect to by that local foreign court[100]. This order can also be accompanied by a **search order**, a **writ ne exeat regno order** (proscribing the defendant from leaving the jurisdiction of England or giving up his passport) or a **gagging order** (which precludes the defendant from informing third parties of the existence of the proceedings and the delivery of any order).

A **Norwich Pharmacal order** seeks to bind institutions such as banks, accountants or financial advisers (which are voluntarily or involuntarily mixed up in the wrongdoing to the claimant) to a full and frank disclosure

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95 *Ibid.*, 10 – "*The three payments which were made after the transfer of the bribe moneys into Durant Account cannot be traced to the appellants because there is no sound doctrinal basis for 'backwards tracing'.*"

96 *Ibid.*, 18.

97 *Ibid.*, 40.

98 See *James Roscoe (Bolton) Ltd.* v. *Winder*, (1915) 1 Ch 62 and *Goldcorp Exchange Ltd., In re*, (1995) 1 AC 74.

99 *T.S.B. Private Bank International SA* v. *Chabra*, (1992) 1 WLR 231.

100 *Babanaft International Co. SA* v. *Bassatne*, 1990 Ch 13.

of the information sought by the order[101]. The involvement of the respondent in the wrongdoing shall be undoubtedly established by the claimant to seek this order and the involvement shall not be merely of a witness to the wrongful act by the company[102]. A **Bankers Trust order** shares similar features to the **Norwich Pharmacal order** but is limited to the delineation of the location of the assets[103].

Asset tracing in India – The strategically emergent considerations

The Insolvency law in India has been stationed upon the doctrines widely acclaimed in common law jurisdictions[104]. It is not a novel idea, but has gained prominence since the advent of urbanization in India. An augmented insolvency resolution regime in a jurisdiction is an indicator of the gradual drift from a centrally planned economy to a market controlled economy[105]. Hence, a rationalized and streamlined insolvency resolution mechanism assumes paramount significance to sustain in this extensively globalized universe.

Considering the anecdotal evidence on the saddening state of affairs in the courts and tribunals during the insolvency resolution proceedings, it is imperative to state that the World Bank's Ease of Doing Business Index in 2015 ranked India 137 out of the 187 jurisdictions[106]. Prior to the enactment of the Code, there existed a colossal variety of adjudicatory forums for matters relating to insolvency resolution[107]. This resulted in extreme chaos. The prepotency of corporate debtors over the creditors led to credit scarcity and hence, adversely affected the integral economy. The Supreme Court while deciding its first case under the newly enacted Insolvency and Bankruptcy

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101 *Norwich Pharmacal Co.* v. *CCE*, 1974 AC 133 (HL).

102 *Ashworth Hospital Authority* v. *MGN Ltd.*, (2002) 1 WLR 2033.

103 *Bankers Trust Co.* v. *Shapira*, (1980) 1 WLR 1274.

104 Bankruptcy Law Reform Committee, The Report of the Bankruptcy Law Reforms Committee Volume I Rationale and Design, F. No. 7/02/2014-FSLRC (2015); Gerard McCormack, "Universalism in Insolvency Proceedings and the Common Law" (2012) 2 Oxford Journal of Legal Studies 32.

105 Evan D. Flaschen and Timothy B. DeSieno, "The Development of Insolvency Law as Part of the Transition from a Centrally Planned to a Market Economy", (1992) 26 The International Law 3, 667-694 (1992).

106 World Bank, Ease of Doing Business, (May, 2018), <http://www.doingbusiness.org/en/data/exploretopics/resolving-insolvency> accessed 19 May 2018

107 Aparna Ravi, "Indian Insolvency Regime in Practice: An Analysis of Insolvency and Debt Recovery Proceedings", (19 December 2015), <https://www.epw.in/journal/2015/51/special-articles/indian-insolvency-regime-practice.ht ml?0=ip_ login_nocache%3De8f-217853e54428113c6d8723fb15724> accessed 19 May 2018.

Code, 2016 noted that the Code has brought a paradigm shift in the law and has introduced the concept of creditor in control in India, wherein the management of the corporate debtor and its assets are deprived of their control after the Code is triggered[108].

In this backdrop, it becomes indispensable for the purpose of this research to address the statutorily granted mechanisms for asset tracing in India. The extant statutory framework in respect of asset tracing in India consists of a collective understanding of the Insolvency and Bankruptcy Code, 2016 along with the allied rules and regulations, the Indian Contract Act, 1872, the Companies Act, 2013, the Transfer of Property Act, 1882, the Indian Trusts Act, 1882, the Code of Civil Procedure, 1908, the Code of Criminal Procedure, 1973, the Indian Penal Code, 1860 and any other sector specific law relating to the facts at hand. Considering the common law orientation of India, the law based on precedents also needs to be conjunctively appreciated with the statutory apparatus.

Judicial Apperception to creation of "constructive trusts"

The idea of creating a constructive trust was impliedly recognized in India in the case of RBI v. Bank of Credit and Commerce International (Overseas) Ltd.[109] This was a case where the "**margin money**" deposited by the applicant in a separate margin account of the bank was sought to be included in the general assets of the bank for the purposes of a ratable distribution of assets. The court held that the relationship between the bank and the applicant was that of a trustee and a beneficiary and hence, on the commencement of insolvency of the bank, (trustee) the moneys due to the applicant shall be fully recoverable and it will not form part of the insolvency estate.

The court further held that if the bank mixes the trust money into its funds and assets and puts it into use, the doctrine of tracing shall find its applicability to guard the interests of the beneficiaries. The court placed a heavy reliance on the Supreme Court's judgment in 1961 in the case of New Bank of India Ltd. v. Pearey Lal wherein it was categorically held that the when money is held by the bank with special standing instructions and is being earmarked to be put to use only for some specific purposes, the bank will be considered to be entrusted with it and it cannot form part of the settlement scheme for the bank[110]. Similarly, it has also been held that when

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[108] *Innoventive Industries Ltd.* v. *ICICI Bank,* (2018) 1 SCC 407.

[109] *RBI* v. *Bank of Credit and Commerce International (Overseas) Ltd.*, 1992 SCC OnLine Bom 528 : (1993) 78 Comp Cas 207, 34.

[110] *New Bank of India Ltd.* v. *Pearey Lal*, AIR 1962 SC 1003.

an amount is being credited to the suspense account in the bank's books of accounts, (awaiting specific instructions for the application of that money) it is to be refunded in full to the depositors in the event of insolvency as the relation in such cases is of fiduciary nature[111].

In cases where a bank or financial service provider is not involved in the transaction, the Supreme Court has held that a constructive trust can only be created by placing a specific reference to the terms of the agreement between the parties[112]. The court held that a contractually agreed security deposit will not be treated as a trust unless the intention of the parties is made express by the agreement that a trust condition shall be created for repayment of the deposit.

Thus, it is unclouded that the Indian judiciary has been repeatedly applying the doctrine of creation of constructive trusts (although without clearly mentioning and referring to this doctrine) for tracing the assets which have either been misappropriated by the insolvent entity or mixed with its own assets and put to its own use[113].

Tracing defaulter and its assets – Improvisations in Banks' recovery

The Indian situation post the banking scams (such as the Nirav Modi scam, Kingfisher's fiasco, Satyam scandal etc.) is not unknown. The skyrocketed NPAs and bad debt in the banks formed one of the considerations for a speedier enactment of the Insolvency code in India[114]. The Code was introduced in Lok Sabha on December 21, 2015[115] and it was enacted on May 28, 2016[116]. The short span of time in which the Code was enacted evidences the exigency to reshape the obsolete and ineffective laws relating to insolvency resolution mechanisms.

The manner and extent of involvement by the banks in tracing the assets of the defaulters has depicted a radical turnaround in the past few years. As opposed to the traditional setting wherein the banks used to accept the blow

[111] *Official Assignee* v. *Natesam Pillai*, 1939 SCC OnLine Mad 366 : AIR 1940 Mad 441.

[112] *Rai Bahadur Seth Jessa Ram Fatehchand* v. *Om Narain Tankha*, AIR 1967 SC 1162.

[113] *Monie Ardeshir Baria* v. *Controller of Estate Duty*, 1975 SCC OnLine Bom 166 : (1977) 106 ITR 203, 20 Trusts Act, 1882, S. 63.

[114] Report of the Bankruptcy Law Reforms Committee Volume I: Rationale and Design <ttps://ibbi.gov.in/BLRCReportVol1_04112015.pdf> accessed 20 April 2018.

[115] PRS Legislative Research, The Insolvency and Bankruptcy Code, 2015, <http://www.prsindia.org/billtrack/ the-insolvency-and-bankruptcy-bill-2015-4100/> accessed 18 April 2018.

[116] Act No. 31 of 2016, The Insolvency and Bankruptcy Code (28 May 2016).

to their balance sheets on defaults, they have now begun to employ private detectives to trail the moneys and trace the assets even if they are hidden abroad[117]. This neoteric fierceness can be seen as an instance of the effect of public anger against crony capitalism. A precedent can be the tracing of the personal assets of Mr. Sunil Kakkad, head of the Ahmedabad based information technology company Sai Info System (India) Ltd (SIS). The company had impending loans of approximately 1.41 crores with the State Bank of India and Mr. Kakkad absconded[118]. The SBI hired investigators only to unfold that Mr. Kakkad had transferred the assets belonging to the company to his own personal accounts and his companies' accounts and had also purchased properties in Liberia.

The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) has been amended to arrange for a faster recovery with a provision for three months' imprisonment if the borrower fails to make due provision of the asset details and for the lender to get possession of mortgaged property within 30 days[119]. Further, the enactment of a detailed circular to facilitate the effective use of section 35AA of the Banking Regulation Act, 1949 allows the central bank to initiate insolvency for the defaulters to deal with the issue of stressed assets.

Asset tracing – Picture painted by the IBC

The Insolvency and Bankruptcy Code assimilates numerous provisions for preventing the conclusion of such defrauding transactions as well as facilitating the unraveling of the assets of the corporate debtor or its equivalent proceeds to assure the betterment of the general body of creditors. In consonance with the internationally accepted practices, the Indian code also contemplates the imposition of a moratorium period. This period has also been termed as the 'pacifying/calm period' wherein the proceedings or executions **against** the corporate debtor and its assets are stayed. Section 14(1) of the Code provides that on the commencement of insolvency, the Adjudicating

117 ET Bureau, "More Banks Hiring Financial Detectives to Trace Personal Assets of Defaulters" *The Economic Times* (Mumbai, 20 February 2015), <https://economictimes.indiatimes.com/industry/banking/finance/banking/more-banks-hiring-financial-detectives-to-trace-personal-assets-of-defaulters/articleshow/46306251.cms> accessed 4 April 2019.

118 Virendra Pandit, "Sai Info CMD 'Siphoned Off Rs 40 Cr' before He Went 'Missing', Say Staff in Plaint" *The Hindu Business Line* (Ahmedabad 19 September 2013) <https://www.thehindubusinessline.com/info-tech/sai-info-cmd-siphoned-off-rs-40-cr-before-he-went-missing-say-staff-in-plaint/article23114693.ece>.

119 PIB Delhi, Measures to Recover Loan Amount from NPAs, (July 2018) <http://www.pibregional.nic.in/PressReleaseIframePage.aspx?PRID=1539834> accessed 1 April 2019).

Authority shall declare the moratorium[120]. Insolvency commencement date is the date of admission of the application for initiating the insolvency resolution process and the appointment of interim resolution professional[121].

The moratorium precludes a variety of actions against a corporate debtor including creating a charge or encumbering the assets of the corporate debtor[122] except the supply of essential goods or services to the corporate debtor[123]. It also extends to the preclusion of any transfer, encumbrance, alienation or disposal of assets or any beneficial interest by the corporate debtor[124]. The horizon of section 14(1)(b) is narrowed to extend its coverage to the property and assets of the corporate debtor and not those owned by its promoters[125]. This provision in the Code confirms that the corporate debtor does not strip off its value during the process and if it does so, it shall attract the punishment prescribed under section 74 of the Code.

Additionally, the Code also mandates the collection of asset details and taking control and custody of the assets of the corporate debtor by the interim resolution professional ('IRP')[126]. However, if the asset is owned by a third party and merely possessed by the corporate debtor under a contractual arrangement or a trust, (which can be by an agreement or by the operation of law) it shall not form part of these obligations of the IRP[127].

Furthermore, to guarantee a consented variation of the creditor's rights and interests in the corporate debtor post commencement of the process under the Code, section 28 places a mandatory condition of seeking an express approval by the committee of creditors for undertaking certain specified actions by the RP[128]. Creation of any security interest over the assets of the corporate debtor and recording any change in the ownership of the assets are two of the specified actions under section 28. It enables the committee to keep an eye on the transactions being undertaken by the RP concerning the assets of the corporate debtor. It acts as a deterrent for the RP. If any action contravening this section is undertaken, it shall be considered void and the

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[120] Insolvency and Bankruptcy Code, S. 14(1).
[121] Insolvency and Bankruptcy Code, S. 5(12).
[122] Insolvency and Bankruptcy Code, S. 14(1).
[123] Insolvency and Bankruptcy Code, S. 14(2).
[124] Insolvency and Bankruptcy Code, S. 14(1)(*b*).
[125] *Alpha & Omega Diagnostics (India) Ltd.* v. *Asset Reconstruction Co. of India Ltd.*, 2017 SCC OnLine NCLAT 394; *Schweitzer Systemtek India (P) Ltd.* v. *Phoenix ARC (P) Ltd.*, 2017 SCC OnLine NCLAT 235 .
[126] *Ibid.*, Ss. 18(*a*) and (*f*).
[127] *Ibid.*, Expln. (*a*).
[128] V.S. Wahi, *Treatise on Insolvency & Bankruptcy Code* (Bharat Law House 2018).

committee shall also have the right to report such actions of the RP to the Adjudicating Authority for taking necessary actions against him[129].

The liquidator has been granted wide powers for taking any measures he considers necessary for the effective protection and preservation of the assets of the corporate debtor[130]. He acts in a fiduciary capacity for the benefit of the creditors[131]. It is worth noting that the liquidator holds the liquidation estate for the benefit of the creditors only and not for any other stakeholders such as contributories in the process.

Exposition of Asset tracing in Preferential, Undervalued, Fraudulent and Extortionate Transactions

The transaction avoidance power of the resolution professional is one of the most discussed concepts amongst insolvency resolution ideas. However, the nature and the consequent ramifications of the orders which are permitted to be passed by the Adjudicating Authority under the Code are a little less explored. This article seeks to achieve a clarity on the same by engaging in a high-level analysis of the nature of these orders and its implications for the parties.

Section 36(3)(f) of the Code includes assets or any value recovered as a consequence of avoidance of transactions in the meaning of "**liquidation estate**". Section 44 of the Code enumerates the list of orders which can be promulgated by the Adjudicating Authority in the cases of preferential transactions. It includes a direction to any persons to pay an equivalent sum accounting for the benefits received by him from the corporate debtor[132].

This is illustrated as one of the explicitly stated mirror images of the doctrine of constructive trusts as prevalent in the United Kingdom which facilitates asset tracing under the Code[133]. The Bankruptcy Law Reforms Committee clearly acknowledged the necessity of a stricter scrutiny of these transactions and the grant of certain enabling powers to the Adjudicating Authority for reversing the effect of such transactions. It was perceived in the discussions that this property shall be held by a third party as trustee and is required to be distributed through the waterfall as prescribed under section 53 of the Code.

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129 *Ibid.*, Ss. 28(4) and 28(5).
130 *Ibid.*, S. 35(1)(*d*).
131 *Ibid.*, S. 36(2).
132 *Ibid.*, S. 44(1)(*c*).
133 Report of the Bankruptcy Law Reforms Committee Volume I: Rationale and Design <ttps://ibbi.gov.in/BLRCReportVol1_04112015.pdf> accessed 20 April 2018.

RECOMMENDATIONS AND CONCLUDING COMMENTS

A remarkable amount of advancement can be witnessed in the theory and practice of the insolvency framework. A comparative understanding of these laws in various jurisdictions has been entailed due to the current transformation in favor of globalization and integration taking effect across the globe. It is imperative to apprise oneself of the differing legal and judicial apparatus for insolvency resolution while contemplatingthe setting up of any business. As it is believed, one should be optimistic but not to the extent of becoming a rabbit to be defeated by the slowly approaching tortoise of financial difficulties and finally, insolvency.

Insolvency might not only knock at a company's door due to its own faults or negligent handling of its business. There may be a myriad of reasons. For instance, as Fin-Techs are developing, (such as the online payment platforms like Paytm, PhonePe etc.) if in future the traditional banking system fails or banks get insolvent, it shall be on account of their displacement by technological superiority of the Fin-Tech entities (it is not always the company's fault, it might just get unfortunate).

One of the elementary rationales for the enactment of any insolvency law in any jurisdiction shall always be to satisfy the creditors on account of the incapacitated state of affairs of the debtor and concurrently expedite an effective resolution for the debtor. Henceforth, the legal avenues and vacuums placed for "asset tracing" assumes significance. This article has attempted to kick-start a high level discussion about the differing ramifications of the tools provided for asset tracing in India, United Kingdom and United States.

On a prima facie stratum, Indian insolvency framework is wholly different from the U.S framework. In United States, the debtor-in-possession regime is applied while, on the contrary, in India, we have recently shifted the focus on the creditor-in-control model from the erstwhile debtor management set up under the Companies Act, 2013 and 1956. The contrasting base line of entitlements in India and U.S is the reason for this difference.

In India, as it is not unknown, one of the underlying objectives of the Code was to address the issue of piled up NPAs and bad debt with the banks and financial lenders. Therefore, the new law had to be titled in favor of creditors (specifically the financial creditors). Henceforth, we have a committee of secured creditors unlike in U.S where it is agreed that secured creditors are already empowered enough to resume with their actions against the company after the automatic stay is lifted and hence, a committee of unsecured creditors shall be a viable option to balance the dichotomy of rights and entitlements between both the classes of creditors. In U.S., the problem of NPA was addressed long back. They believe that the debtor is the best entity to resolve its own insolvent state and it is best apprised of all the nitty-gritties of its own functioning and operations. However to avoid any conflicting situations, the Bankruptcy Code also makes due provisions for replacing the debtor-in-possession with a managing trustee (where there is any claim of fraudulent behaviour or the debtor is incompetent to deal with the issue).

In due course of this article, the author analyzed that the Bankruptcy Code contains numerous provisions to assist the creditors and debtors to trace their assets or an equivalent benefit and to consolidate and accumulate the bankruptcy estate such as the imposition of automatic stay to prevent any dissipation of assets, avoidance actions to reclaim the assets for the benefit of the estate and discovery mechanisms to trace the location, nature and value of the assets. Similarly in the United Kingdom, the Insolvency Act empowers the office holders to take appropriate actions for the recovery of assets. Moreover, there are other mechanisms as well outside the Act to seek orders form the civil courts. Indian situation can be rightly concluded to be at a nascent stage, as under the Insolvency Code, we do not have express provisions recognizing the concept of "asset tracing" as of now. However, practically, the Code promotes efficient measures to be undertaken for recovering the assets.

One of the stark differences marked by the author is in respect of the tripartite relationship between the office holder, the company (or the corporate debtor) and the creditors (individually as well as a general body of creditors) in India and the United Kingdom. Indian law attaches a fiduciary relation between the liquidator and the creditors of the corporate debtor, however, in UK, (as it is pointed while analyzing the case law pertaining to misfeasance claims) the relation is seen to be established between the company and the office holder.

The Indian code provides that the liquidator shall be a fiduciary for the "**benefit of the creditors**". This phrase has not been raised for interpretation of the judicial authorities as of now. However, a literal and coherent understanding of the same is the establishment of a fiduciary relationship between the creditors and the liquidator. Therefore, this issue is still unaddressed and requires a legislative clarity.

Moreover, as noted earlier as well, there is a dire need of incorporating specific provisions in the Code with respect to asset-tracing such as the discovery mechanisms or a reference to the Civil Courts for claiming injunctions etc. Although in the banking sector, continuous amendments are being deliberated to strengthen the recovery process as well as to create a deterrent effect for the defaulters.

Besides appreciating the ramifications of the recent amendment to the Code and to the allied regulations, it is worth noting that guarantors to the corporate debtor have been ousted from the scope of section 14. In most of the situations, a guarantor to the corporate debtor is a person from the Board of the company or a promoter and willat least bea related party to the company. In this scenario, one of the appalling implications can be the dissipation/disposal of the property owned in the name of the guarantor but a beneficial interest is held by the debtor. Therefore, this amendment leads to the creation of a loophole for the stricter scrutiny of prevention of asset disposal.

The argument that guarantors and the corporate debtor shall stand and be treated as separate entities seems to be contradicted by section 44(1)(e) of the Code. This provision states that the Adjudicating Authority shall have the power to direct any guarantor in case of a preferential discharge of obligations to be a guarantor under the new or revived debts. Where the orders under this provision can stand applicable to a guarantor, it raises concerns as to why should moratorium not apply to guarantors.

The position in the United States should be considered by the Indian law making agencies in this respect. In the United States, the automatic stay shields the debtor and its property only and excludes any guarantors to the debtor or its affiliates. This position stands similar to the ruling position in India as well but it exists with a pinch of discretion with the bankruptcy courts. If it appears that sidelining the guarantors or affiliates of the corporate debtor from the operation of the automatic stay interferes with the ability of the debtor to reorganize successfully, it may enjoin them as well.

This position seems more secured. However, a contrary opinion against the same can be the risk vis-à-vis the capacity of the Indian judicial system to exercise this discretion wisely and ensuring that this exception does not become a rule, especially when the Adjudicating Authorities have been recently constituted and have not dealt with a plethora of cases.