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An e-newsletter from
Lakshmikumaran & Sridharan, India

June 2021 / Issue–117

Contents

June
2021

Articles

Introduction of the 'On-going Projects' regime under CSR – A Welcome Move

By **Noorul Hassan and Kumar Panda**

"*It must be remembered that law is not a mausoleum. It is not an antique to be taken down, dusted, admired and put back on the shelf. It is rather like an old vigorous tree, having its roots in history, yet continuously taking new grafts and putting out new sprouts and occasionally dropping dead wood*."

- Justice Bhagwati in *Motilal Padmapat Sugar Mills Co (P) Ltd.* v. *Uttar Pradesh*, AIR 1979 SC 621

Though the primary objective of Corporate Social Responsibility ('**CSR**') was not slated to be to bridge resource gap for the Government, the second wave of the pandemic Covid-19 has once again brought back into light the participation of Corporate India in supplementing the efforts of the Government.

Since the inception of CSR provisions, under the Companies Act, 2013 ('**2013 Act**'), corporates have contributed heavy amounts to the social fabric of the country, with health care and education sectors receiving up to 65% of the total contribution[1]. As of March 2020, the corporates have spent INR 89,335 crore towards CSR contributions.

Looking at the level of its impact over the years, there were two High Level Committees ('**HLC**') that were set up to suggest necessary changes to the CSR provisions, one in 2015 and the second one in 2018. Being one of the first nations to impose CSR obligation as a statutory requirement, the provisions required modifications based on the learnings from the initial implementational years.

Accordingly, the Companies (Amendment) Act, 2020 ('**2020 Amendment**') amended the CSR provisions provided under Section 135 of the 2013 Act. The said amendment was notified on 22 January 2021, along with the Companies (Corporate Social Responsibility) Amendment Rules, 2021. These were based on the recommendation of the HLC 2018.

Due to the nature of the amounts being spent i.e., the companies are either to spend or give reasons for not spending approach, the HLC 2018 had noted that on account of various reasons such as not finding a suitable project, delay in implementation of the plan and long duration projects, lack of prior experience, etc., companies were not fully spending the allocated funds in a given financial year. Therefore, the amendments that were brought in address these issues to a large extent. Some of the significant amendments are as follows:

Shift from 'Discretionary' to 'Mandatory' regime

The provisions were initially interpreted as discretionary as, by merely specifying reasons for not spending funds towards CSR obligations in the Board Report, a company can be discharged from the obligation to undertake CSR activities.[2]

[1] Data as available at: https://CSR.gov.in.

[2] *See* HLC 2018 report dated 7 August 2019, available at: https://www.mca.gov.in/Ministry/pdf/CSRHLC_13092019.pdf

The 2020 Amendment now rectifies this issue and makes it mandatory to transfer the unutilized CSR funds to funds specified under Schedule VII of the 2013 Act, within 6 months from the closure of the relevant financial year.

The HLC 2018, in its report ('**HLC 2018 Report**'), noted that mandating huge spending by corporates in one year without considering financial and operational challenges will not lead to desirable outcomes. It has, therefore, recommended that unspent CSR amount for a year be transferred to a separate designated account created for the purpose, and such unspent amount, and the interest earned thereon, be spent within a period of three to five years.

Acting on the recommendations, the 2013 Act now incorporates a provision under Section 135(6) of the said Act to enable corporates to transfer unspent amounts concerning an 'on-going project' to a separate account designated as an '***Unspent CSR Account***' and the amounts be spent in the next 3 financial years towards that on-going project. The amounts concerning an 'on-going project' remaining unspent after 3 years are to be transferred to the funds specified in Schedule VII of the 2013 Act.

Concept of On-going Project

The Companies (CSR Policy) Rules, 2014 ('**CSR Rules**') defines an 'on-going project' as a multi-year project undertaken by a company in fulfilment of its CSR obligations, having timelines not exceeding three years excluding the financial year in which it was commenced, and shall include such project that was initially not approved as a multi-year project but whose duration has been extended beyond one year by the board based on reasonable justification.

To be able to claim the benefit of multi-year spending of CSR funds, a company is required to approve a CSR initiative as a multi-year project initially or extend an already approved one-year project beyond one year with reasonable justification.

The unspent CSR account to be opened under Section 135(6) of the 2013 Act is year specific. If a company has one or more multi-year projects approved by the Board, for transparency and tracking the funds, the number of unspent CSR accounts can be one for each multi-year project. General allocation to activities of NGOs may not qualify as an on-going project, as they may not have any defined timelines, which is essential to qualify as an on-going project. Further, the obligation to open an unspent CSR account is on the company and there cannot be a joint account or delegation of the obligation to the implementing agencies.

The provisions provide enough liberty to the Board of the company to decide what constitutes a multi-year project. It can be even phases of a large project, that may constitute an on-going project. Further, companies may also club multiple initiatives under one project provided there is a rationale between two or more initiatives that tie them together. The Board may also provide modifications to an ongoing project to ensure proper implementation of the ongoing project.[3]

Can the unspent amount be re-allocated to a different project?

The amounts that are required to be transferred to an unspent CSR account are the unspent amounts allocated for a project in a given financial year in the said financial year.

[3] *See* Rule 4(6) of the CSR Rules.

Further, as per the annual CSR report in the specified format to be provided in the Board's report, each project is to be assigned a Project ID. If CSR projects are recognized under different project IDs in the Board's report, the amounts remaining unspent against an on-going project after the end of a financial year cannot be diverted to another project, as long as the project against which it was initially allocated remains incomplete.

If an on-going project is completed before the period planned, and some part of the allocated amounts are left unspent, the Board may pass a resolution, based on the recommendation of CSR Committee appointed under the 2013 Act, and allocate the amounts to other projects or transfer it to funds established in Schedule VII of the said Act. We may note that the philosophy of CSR is to engage businesses as partners in social development, wherein fiduciary duties have been cast upon directors of the company to ensure the same are implemented in the best interests, *inter alia*, of the community and environment[4], and therefore the transfer of CSR funds to Schedule VII specified funds is to be the last resort.

At this juncture, it is also important for the Board to carefully approve multi-year projects. Transferring more than required amounts to an unspent CSR account can result in the amounts ultimately being transferred to funds specified in Schedule VII, if they remain unspent after 3 years.

Obligations of the Board in case the amounts are transferred to a Section 8 Company, registered trust, or society

The company may engage agencies for implementing its CSR Activities. As provided in the HLC 2018 Report, mere disbursal of funds to implementing agencies is not to be construed as a company spending towards CSR. The company must ensure that the funds are utilized for the stated projects by the implementing agencies. In the event that the amounts disbursed to the implementing agencies remain unspent after a financial year, the obligation is on the company to comply with the provisions of the law and transfer the unspent CSR amounts to the funds specified under Schedule VII of the 2013 Act, and treat them as spent, once the said agencies have actually spent them. This may also be applicable to ongoing projects conducted through implementing agencies as well, but this may pose a variety of issues as to what amounts have been spent, when it comes to seeking for transfer of funds.

Parting remarks

The on-going project provisions will encourage companies to take up long-term projects that create social capital. It is recommended that companies undertake prior and proper due diligence before engaging any implementation agency for implementation of its CSR activities, as the ultimate obligation still lies with the company to ensure proper expenditure of the CSR amounts. Further with effect from financial year 2021-22, the chosen implementing agencies must be registered by filing form CSR-1 to be eligible to act as such and receive CSR funds. The amendments are based on the learnings from initial implementational years of the CSR regime and are aimed at transforming the companies into Socially Responsible Corporates ('**SRC**').

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[4] HLC CSR Report 2018

Limitation for filing of appeals under Section 37 of Arbitration and Conciliation Act

By **Rashi Srivastava and Ankit Parhar**

Section 37 of the Arbitration and Conciliation Act, 1996 ('**Act**') provides for an appeal against orders passed under Sections 9, 34, 16 and 17 of the Act. The Act does not provide any specific limitation for filing such appeals. However, Section 43 of the Act provides that the Limitation Act, 1963 ('**Limitation Act**') shall apply to arbitrations as it applies to proceedings in Court.

Articles 116 and 117 of the Schedule of the Limitation Act provide for a limitation period of 90 days for filing an appeal from any other Court to a High Court and a period of 30 days for filing an intra-High Court appeal, respectively. Further, Section 5 of the Limitation Act provides for extension of the prescribed limitation period in cases where the applicant satisfies the Court that there was a 'sufficient cause' for such delay.

Prior to the enactment of the Commercial Courts Act, 2015 ('**Commercial Courts Act**'), the Supreme Court, in *Consolidated Engineering Enterprises* v. *Irrigation Department*[5] ('***Consolidated Engg.***'), held that, where the Limitation Act prescribes a period of limitation for appeals or applications to any Court, and the special act does not prescribe any period of limitation, then the limitation prescribed in the Limitation Act will be applicable along with Sections 4 to 24 thereof, unless they are expressly excluded by the special act.

Thereafter, the Commercial Courts Act was enacted. Section 10 of the Commercial Courts Act provides that Commercial Courts shall decide all applications and appeals which arise out of arbitrations other than international commercial arbitrations, where the subject matter is a commercial dispute of the specified value. This 'specified value', as defined under Section 2(1)(i) of the said Act cannot be less than INR 3,00,000. Further, Section 13(1A) provides that an appeal under Section 37 of the Act would lie before the Commercial Court and such appeal must be filed within 60 days.

However, in 2020, when faced with the same issue in the case of *Union of India* v. *Virendera Constructions Ltd*[6] ('***Virendra Constructions***'), the Supreme Court did not take into account the Commercial Courts Act and the decision in *Consolidated Engg.* The Supreme Court judicially engrafted a limitation period of 120 days from the date of passing of the order and held that any further delay beyond 120 days cannot be allowed. The Supreme Court noted that, since a Section 34 application has to be filed within a maximum period of 120 days including a grace period of 30 days, therefore, an appeal filed from the same should also be covered by the same drill.

Thereafter, in *N. V. International* v. *State of Assam and Ors*.[7] ('***N. V. International***'), the Supreme Court reiterated the position as stated in *Virendra Constructions*. The Supreme Court also placed emphasis upon the main object of the Act, i.e. speedy disposal of arbitral disputes and held that, any delay beyond 120 days cannot be condoned.

However, neither *Virendra Constructions* nor *N.V. International* case, referred to the provisions of Commercial Courts Act which deal with the limitation period for filing of appeals under

[5] *Consolidated Engineering Enterprises* v. *Irrigation Department* [(2008) 7 SCC 169].

[6] *Union of India* v. *Varindera Constructions Ltd.* [(2020) 2 SCC 111].

[7] *NV International* v. *State of Assam*, [(2020)2SCC109].

Section 37. It must also be noted that neither the Act nor the Commercial Courts Act, provide for this cap of 120 days or limit the period up to which an application for condonation of delay can be allowed.

In *Government of Maharashtra* v. *Borse Brothers Engineers & Contractors Pvt. Ltd,* [8] the Supreme Court noted the conflicting position. The Supreme Court relied on *Consolidated Engg.* and held that, if the specified value of the subject matter is INR 3,00,000 or more, then an appeal under Section 37 of the Act must be filed within 60 days from the date of the order as per Section 13(1A) of the Commercial Courts Act. However, in those rare cases when the specified value is a sum less than INR 3,00,000, the appeal under Section 37 would be governed by Articles 116 and 117 of the Limitation Act, as the case may be.

Regarding the applicability of the Limitation Act, the Supreme Court overruled its decision in *N. V. International* case and held that Section 37, when read with Section 43 of the Act and Section 29(2) of the Limitation Act, makes it clear that Section 5 of the Limitation Act will apply to the appeals filed under Section 37. However, the Supreme Court also noted that condonation of delay, although allowed, cannot be seen in complete isolation of the main objective of the Act, i.e. speedy disposal of disputes. In light of the same, the Supreme Court observed that the expression '*sufficient cause*' under Section 5 of the Limitation Act is not elastic enough to cover long delays, and merely because sufficient cause has been made out, there is no right to have such delay being condoned. The Supreme Court further held that only short delays can be condoned by way of an exception, and not by way of the rule, and that too only when the party acted in a *bona fide* manner and not negligently.

Thus, the applicable limitation period may be summarized as under:

Value of the dispute	Kind of appeal	Governing provision	Limitation
< Rs. 3,00,000	Intra-court	Art. 117, Schedule I, Limitation Act	30 days
< Rs. 3,00,000	Inter-court	Art. 116, Schedule I, Limitation Act	90 days
> Rs. 3,00,000	Inter & Intra-court	Section 13(1A), Commercial Courts Act	60 days

The delay in all the above cases is condonable provided that:

1) The period of delay is short;
2) Sufficient cause has been made out for such delay;
3) The actions of the appellant were *bona-fide*; and
4) No prejudice is caused to the other party.

The Supreme Court in this judgment has not only provided the much-needed clarification on an important point of law but has also re-emphasised the main objective of speedy disposal of disputes under the Act. The Supreme Court went a step ahead and also observed that be it a private party or a public sector company, the same yardstick will be applicable for condonation of delay, and no special treatment can be afforded merely because the government is involved.

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[8] *Government of Maharashtra* v. *Borse Brothers Engineers & Contractors Pvt. Ltd,* [2021 SCC OnLine 233].

Notifications and Circulars

Companies (Incorporation) Rules, 2014 amended for fourth time in 2021: The Ministry of Corporate Affairs has on 7 June 2021 amended the Companies (Incorporation) Rules, 2014 ('**Rules'**) for the fourth time this year. In terms of the latest amendment, now the application for incorporation will also require proof of registration under the relevant Shops and Establishment Act. Consequently, the application for incorporation of a company under Rule 38 of the Rules will now be required to be accompanied by new e-form 'AGILE-PRO-S' instead of 'AGILE-PRO'. The new form has also been notified.

SEBI's Technical Group on Social Stock Exchange (SSE) issues recommendations: Securities and Exchange Board of India's Technical Group on Social Stock Exchange has made the following key recommendations:

- Corporate foundations, political and religious organisations, professional or trade associations, infrastructure companies and specified housing companies, should be made ineligible to raise funds using the SSE mechanism.
- An illustrative list of instruments/ mode of raising finance has been recommended. Accordingly, for Non-Profit Organisations (NPOs), the list of instruments/mode would include equity, Zero Coupon Zero Principal bonds, Mutual Funds, Social Impact Funds, and Development Impact Bonds. In case of For-Profit Enterprises (FPEs), the list will include equity, debt, social impact funds, and development impact bonds.
- Three parameters have been suggested to establish the social impact objective on the enterprises — first, the activities of the entities have to fall within 15 broad eligible areas as specified, that include eradicating hunger and poverty, promoting education, health, financial inclusion, protection of national heritage, etc.; second, that the activities should be targeted towards the underserved or less privileged population segments or regions, and, third, that at least 67% of the social enterprise's activities should qualify as eligible activity for the target population.

Innovators Growth Platform – SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 amended: The SEBI has, *vide* the (Substantial Acquisition of Shares and Takeovers) (Amendment) Regulations, 2021 notified on 5 May 2021, amended the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011. The said amendment substitutes 'Institutional Trading Platform' with the words 'Innovators Growth Platform'. For substantial acquisition of shares or voting rights, and for Voluntary Offer in case of a listed entity that has listed its specified securities on Innovators Growth Platform, any reference to 'twenty-five per cent' shall be read as 'forty-nine per cent'. Further, for disclosure of acquisition and disposal, any reference to 'five per cent' shall be read as 'ten per cent' in case of a listed entity that has listed its specified securities on the Innovators Growth Platform.

Business Responsibility and Sustainability Reporting by listed entities: SEBI has introduced new reporting requirements on Environment, Social and Governance ('**ESG**')

parameters called the Business Responsibility and Sustainability Report ('**BRSR**'). This is in terms of the amendment to Regulation 34(2)(f) of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 *vide* Notification No. SEBI/LAD-NRO/GN/2021/22 dated 5 May 2021. The key disclosures sought in the BRSR are highlighted below:

- An overview of the entity's material ESG risks and opportunities, approach to mitigate or adapt to the risks along-with financial implications of the same.
- Sustainability related goals & targets and performance against the same.
- Environment related disclosures covering aspects such as resource usage (energy and water), air pollutant emissions, green-house (GHG) emissions, transitioning to circular economy, waste generated and waste management practices, bio-diversity, etc.
- Social related disclosures covering the workforce, value chain, communities and consumers.

Draft Trade Union Rules issued: The Ministry of Labour and Employment has published the draft Industrial Relations (Central) Recognition of Negotiating Union or Negotiating Council and Adjudication of Disputes of Trade Unions Rules, 2021. The following important rules have been proposed to be introduced:

- Rule 3 specifies the matters for negotiation with employer in an industrial establishment having a registered trade union for negotiating on behalf of the workers employed.
- Rule 4 specifies the criteria for recognizing a single registered Trade Union of workers as sole negotiating Union of workers.
- Rule 5 enumerates the manner of verification of membership of Trade Unions in an industrial establishment.
- Rule 6 states the criteria for verification of membership of Trade Unions through secret ballot.
- Rule 7 states the verification report of the membership of trade union to be sent to the employer of the industrial establishment.
- Rule 8 enumerates criteria for recognition of Trade Union as negotiating union or constituents of negotiation council.
- Rule 9 lists the facilities to be provided by industrial establishments to a negotiating union or negotiating councils.
- Rule 10 specifies the manner of making an application for adjudication of disputes before Tribunal.

Foreign Exchange Management (Borrowing and Lending) Regulations, 2018 amended: RBI has on 24 May 2021 issued Foreign Exchange Management (Borrowing and lending) (Amendment) Regulations, 2021 to make amendments in the Foreign Exchange Management (Borrowing and Lending) Regulations, 2018. As per the new amendment, 'An Authorised Dealer in India may lend to a person resident outside India for making margin payments in respect of settlement of transactions involving Government Securities by the person resident outside India'. According to the changes in Regulation 7(A), the expression 'Government Security' shall have the same meaning as assigned to it in Section 2(f) of the Government Securities Act, 2006.

SEBI (Alternate Investment Funds) Regulations, 2012 amended: The SEBI has on 5 May *2021* vide the SEBI (Alternative Investment Funds) (Second Amendment)

Regulations, 2021 amended the SEBI (Alternate Investment Funds) Regulations, 2012. The said amendments remove the negative list from the definition of 'venture capital undertaking' and are pertaining to the definition of 'start-up' as provided by the Government of India. They further clarify the criteria for investment by Angel Funds in a start-up and prescribe a Code of Conduct for AIFs, key management personnel, trustee, trustee company, directors of the trustee company, designated partners or directors of AIFs, etc.

Ratio Decidendi

Petition filed under IBC Section 7 to be decided notwithstanding pendency of application under Arbitration Section 8

The Supreme Court has held that once a petition is filed under Section 7 of the Insolvency and Bankruptcy Code, 2016 ('**Code**'), the Adjudicating Authority is duty bound to only consider the same notwithstanding the fact that an application under Section 8 of the Arbitration & Conciliation Act, 1996 ('**Act**'), for referring the matter to arbitration, is pending before it.

Brief facts:

- The Petitioner and the Respondents had entered into Share Subscription and Shareholders' Agreements wherein the Respondents had subscribed for optionally convertible redeemable preference shares ('**OCRPS**') in the Petitioner company. The Petitioner proposed to redeem and convert the OCRPS held by the Respondents into equity shares. On such conversion, based on the equity shareholding to be thereby held by the Respondents, the Petitioner was to be liable for refund of the balance amount to the Respondents.
- During the negotiation process, disputes arose between the parties regarding the calculation and conversion formula to be applied, with each party claiming a different percentage of shareholding for the Respondents. The Respondents claimed that on redemption of the OCRPS, an amount became due and payable to them and since the Petitioner failed to pay the same, such failure to pay the redemption amount constituted 'default' under the Code. Accordingly, one of the Respondents filed a petition under Section 7 of the Code.
- Before the NCLT, the Petitioner contended that there was no 'debt' or 'default' as per the Code since there was a dispute regarding the appropriate formula. In addition to seeking a dismissal of the petition, the Petitioner also filed an application under Section 8 of the Act seeking a referral of the parties to arbitration (each of the separate agreements between the parties contained an arbitration clause). The NCLT took note of the rival contentions and 'allowed' the

Section 8 application filed by the Petitioner and as a corollary dismissed the Section 7 petition.

- In the meanwhile, the Petitioner had filed an application under Section 11 of the Act before the Supreme Court for appointment of an arbitrator since one of the Respondents being a Mauritius based company, the dispute qualified as an international commercial arbitration. This application remained pending.
- Aggrieved by the decision of the NCLT, one of the Respondents preferred an appeal (by way of special leave) against the Order of NCLT before the Supreme Court. Since both the Section 11 application and the appeal from the NCLT order were between the same parties and related to the same underlying dispute, both the matters were connected and heard together by the Apex Court.

Submissions:

- The Respondents submitted that the NCLT committed a serious error in entertaining the application filed under Section 8 of the Act as there was a legal duty cast upon the NCLT to proceed strictly in accordance with the procedure contemplated under Section 7 of the Code. It was further submitted that the dispute sought to be raised by the Petitioner was not arbitrable after the insolvency proceedings were commenced (by filing the Section 7 petition) as these proceedings were an action *in rem*. The Petitioner on the other hand supported the impugned order as completely justified.
- Separately, the Petitioner in its Section 11 application, sought the appointment of a single arbitral tribunal to adjudicate the disputes under the separate agreements since the subject matter involved was same. However, the Respondents opposed the constitution of a composite arbitral tribunal as the disputes involved an international commercial arbitration (with respect to Respondent No. 1 being a Mauritius based company) and a domestic arbitration (with respect to Respondent Nos. 2 to 4).

Decision:

- The Supreme Court held that while it is well settled that an insolvency proceeding is an action *in rem*, mere filing of the petition under Section 7 of the Code does not make it a proceeding *in rem*. It becomes so only *after* the petition is admitted, not before that event. Therefore, to decide the nature of the proceeding, one has to identify the relevant stage.
- In the present case, the Section 8 application was filed *before* the stage of admission. Accordingly, at such a stage, the proceeding could not be construed as a proceeding *in rem*. During that stage, the Petitioner was entitled to point out that a default had not occurred and that a debt is not due.
- However, even if a Section 8 application is filed during that stage, the Adjudicating Authority is duty bound to first decide the petition under the Code by recording a satisfaction about there being default or not. This is because of the overriding nature of the Code by virtue of Section 238 and the timelines prescribed therein. In addition, the insolvency proceedings cannot be delayed by corporate debtors who may file such Section 8 applications to raise a moonshine defence.

- If the petition is admitted after holding that there is a default, any application under Section 8 of the Act will not be maintainable, as the proceedings would then be actions *in rem*. If the petition is rejected, then the need to pass orders on such Section 8 application would not arise.
- The Supreme Court noted that the Adjudicating Authority was conscious of the fact the petition could only be admitted if there was default and a debt was payable. It observed that it was premature to arrive at a conclusion that there was default in payment of any debt until the dispute regarding calculation and conversion formula was resolved and thereby the amount payable by Petitioner on redemption of OCRPS was determined. The Court noted that the NCLT had rightly arrived at the conclusion that the issue involved had not led to a stage of default. To this effect, the Supreme Court also relied on the correspondence and board meetings between and amongst the parties towards resolving the dispute.
- However, the Supreme Court noted that though the NCLT had actually (and correctly) decided only the Section 7 petition, the operative portion of the impugned order mentioned that the Section 8 application was 'allowed' and as a corollary, the Section 7 petition was dismissed. The Supreme Court observed that in the given facts, it was actually the reverse. Since the NCLT had correctly appreciated the applicable legal principles and pronounced its decision, there was no occasion to interfere with the same in appeal.
- As far as the Section 11 application was concerned, the Court perused the arbitration clause between the parties which was similar for all agreements. Keeping in view that the issues concerned the conversion of shares and formula to be applied therein (which was common across all the agreements), the Court held that the same could be resolved by an arbitral tribunal consisting of the same members but separately constituted in respect of each agreement. In doing so, the Court followed the ruling in *Duro Felguera S.A* v. *Gangavaram Port Limited,* [(2017) 9 SCC 729].
- In view of the findings above, the Supreme Court dismissed the appeal and allowed the Arbitration Petition by appointing an arbitrator.

[*Indus Biotech Private Limited* v. *Kotak India Venture (Offshore) Fund and Others* – Judgment dated 26 March 2021 in Arbitration Petition (Civil) No. 48/2019, Civil Appeal No. 1070/2021 and SLP(C) No. 8120 of 2020, Supreme Court]

Company Court cannot, in winding-up proceedings, decide which party has defaulted compromise

The Supreme Court has held that the Company Court while exercising its powers under Sections 433 and 434 of the Companies Act, 1956 ("**Act**") would not be in a position to decide, as to who was at fault in not complying with the terms and conditions of the deed of the settlement and compromise deed.

Brief facts

- As per the business arrangement between the appellant and the respondent, the respondent had supplied material worth INR 81,98,014.45, against which there was an outstanding balance of INR 8,92,723 to be paid to the respondent. As the payment was not made despite statutory notice under the Companies Act

being duly served on the appellant, the respondent filed a Company Petition seeking winding up of the appellant for its inability to pay this debt.

- The Company Court admitted the said Company Petition. However, while doing so, the Court observed that since the appellant was an on-going concern, an opportunity should be granted to it to settle the accounts with the respondent. Only in case of failure to make settlement of its dues to the respondent, the citation was directed to be published.
- Being aggrieved by this, the appellant had filed an appeal challenging the order of the Company Court before the Division Bench of the High Court of Punjab & Haryana. The High Court had granted a stay against publication of the admission order subject to the appellant paying the outstanding principal amounts.Therefore, the appellant repaid the outstanding amount to the respondent. The High Court held that there was no dispute as the appellant had satisfied the claim of the respondent, and accordingly dismissed the appeal. However, while the High Court declined to entertain the claim with regard to whether the appellant was liable to pay interest at the rate of 24 per cent per annum to the respondent, it granted liberty to the respondent to seek such interest by way of application or appeal. The appellant preferred an appeal against this order before the Apex Court.

Submissions

- The appellant claimed that his defence was a *bona fide* one. That on account of the defective material supplied by the respondent, the appellant had suffered huge losses and as such, it was the appellant who was entitled to receive damages from the respondent. It was further submitted by the appellant that the learned Company Judge ought not to have admitted the Company Petition. The claim of the respondent could not stand even if it was made in summary proceedings under Order XXXVII of the Code of Civil Procedure, 1908.
- The appellant also submitted, that requirements under Section 433(e) and (f) of the Act stood on a much higher pedestal and as such, the learned Company Judge erred in admitting the petition. Since there was no agreement between the parties to pay interest on the balance/delayed payment, the direction issued by the Division Bench of the High Court, that the claim of the respondent for interest may still be considered, does not stand the scrutiny of law.
- It was submitted by the respondent that the appellant in spite of various communications sent by the respondent requesting it to pay the outstanding amount, had failed to do so, it was compelled to issue statutory demand notice under Section 434 read with Section 433(e) of the Act. The said notice was duly served upon the appellant and also replied to. The appellant had totally changed the stand taken by it before the learned Company Court as against the stand taken by it in the reply to the statutory notice. It was therefore submitted that the Company Court as well as the High Court had rightly held, that the defence of the appellant was not a *bona fide* one.

Decision

- The Supreme Court pointed out that if the debt is *bona fide* disputed and the defence is a substantial one, the Court will not wind up the company. It is equally well settled, that where the debt is undisputed, the Court will not act upon a defence that the company has the ability to pay the debt but chooses not to pay that particular debt.
- The principles on which the Court acts are first, that the defence of the company is in good faith and one of substance, secondly, the defence is likely to succeed in point of law, and thirdly the company adduces prima facie proof of the facts on which the defence depends. It could thus be seen, that the Company Court has found, that the defence taken by the appellant with regard to the products of the respondent being defective in quality was by way of an after-thought, inasmuch as, no document was placed on record in support of such contention.
- The respondent was also entitled to the payment of interest. The Supreme Court held that the Company Court, while exercising its powers under Sections 433 and 434 of the Act, would not be in a position to decide as to who was at fault in not complying with the terms and conditions of the deed of settlement and the compromise deed. It was found that, in the said case, a detailed investigation of facts and examination of evidence and interpretation of various terms and conditions of the compromise deed entered into between the parties was necessary in adjudicating the claim, which could not be done in the proceedings under Section 434 of the said Act. Hence, the Bench dismissed the appeal for being devoid of merit.

[*Shital Fibres Ltd.* v. *Indian Acrylics Ltd*., 2021 SCC Online SC 281 – Judgment dated 6 April 2021]

News Nuggets

Creditors/lenders can initiate insolvency proceedings against personal guarantors

The Supreme Court in a recent judgment in *Lalit Kumar Jain v. Union of India [Judgment dated 21 May 2021]* has held that the Notification dated 15 November 2019 ("**Notification**"), which notified the Insolvency and Bankruptcy (Application to Adjudicating Authority for Insolvency Resolution Process for Personal Guarantors to Corporate Debtors) Rules, 2019 ("**Rules**"), is 'legal and valid'. The Notification was challenged before several High Courts as well as the Apex Court, and therefore, the Supreme Court had directed transfer of all petitions from High Courts to itself to provide uniform interpretation on the said Notification and the Rules. The Petitioners *inter alia* contended that the Notification,

which brought into force Section 2(e) of the Insolvency and Bankruptcy Code, 2016 ("**Code**"), thus making the Code applicable to 'personal guarantor to corporate debtor', was *ultra vires* as it selectively made the provisions of the Code applicable to a specific category of persons. Rejecting the said contention, the Supreme Court was of the view that the Central Government has followed a stage-by-stage mechanism to bring in force various provisions of the Code depending upon the priorities and with an aim to fulfil the objectives of the Code. The Supreme Court has also observed that the Central Government had consulted the body of experts, which recommended that personal guarantors to corporate debtors facing insolvency process should also be involved in proceedings by the same adjudicator, and for this, necessary amendments were required. It held that, therefore, the issuance of the impugned notification was well within the powers conferred by the Parliament under Section 1(3) of the Code.

Recoveries from Director for issuance of NCDs in violation of Companies Section 73(2) – Subsequent liquidation proceedings under IBC against company, not material

Observing that the Order of the Whole Time Member of SEBI, against the director of the firm, directing for recovery of monies jointly and severally, was passed prior in time before the initiation of proceedings under the IBC against the Company, the Securities Appellate Tribunal (SAT) has held that the subsequent IBC order initiating liquidation proceedings has no effect in so far as the present recovery is concerned. As per the facts of the case, the SEBI Whole Time Member had, while holding that the collection of the money through the Non-convertible Debentures (NCDs was in violation of Section 73(2) of the Companies Act, 1956, directed the company and its directors to refund the amount collected along with interest jointly and severally. On appeal, the appellant-director had contended that since proceedings were initiated under the Insolvency and Bankruptcy Code, 2016, IRP appointed, moratorium imposed, and thereafter, the Company was pushed into liquidation, the assets of the company were being liquidated and hence no amount should be recovered from the appellant till finalization of the liquidation proceedings, as the money realized would be sufficient to recover the refund towards NCDs. The SAT, in this decision *Rajesh Kumar Agarwal* v. *SEBI* [Judgment dated 24 March 2021] also rejected the appellant's plea that some amount should be allowed to be taken out from his bank account for his survival.

Insolvency – Value of security or recoverability of debt not material for not triggering CIRP

The National Company Law Tribunal (NCLT), Mumbai has held that, in a Petition under Section 7 of the Insolvency and Bankruptcy Code, 2016, only the debt and default need to be looked into and that the value of the security would have no bearing on the legal requirement, which when satisfied would trigger the Corporate Insolvency Resolution Process (CIRP). The Corporate defaulter had plead that assets mortgaged and or hypothecated to the financial creditor were of a very high value and hence, the dues were secured by the said assets. Rejecting this ground against a petition under IBC, the NCLT held that the value of the security and the recoverability of the debt would not obliterate the fact of default. It noted that there was no dispute and that there was default in payment of the financial debt. The NCLT in the case *Piramal Capital and Housing Finance Ltd.* v. *SK Elite Industries (India) Ltd.* [Order dated 7 May 2021] also held that a suit

filed before the High Court against the guarantors of the debtors does not prohibit the creditor from initiating CIRP against the debtors.

Environmental clearance for industrial units – States do not have power to grant exemption

Observing that industrial units are required to obtain Environmental clearance ('**EC**') as per the Environment Impact Assessment notification issued by the Ministry on 14 September 2006, the National Green Tribunal (NGT) has held that the State has no power to exempt the requirement of prior EC or to allow the units to function without an EC on payment of compensation. As per the facts of the case, the State of Haryana had, *vide* Order dated 10 November 2020, allowed the manufacturers of formaldehyde to operate for a period of six months without an EC. State of Haryana submitted that the units were granted interim relief as the said Notification was being redrafted by the Ministry and no draft was shared till date. The NGT relied on the decision of the Supreme Court in *Alembic Chemicals* v. *Rohit Prajapati & Ors.,* [2020 SCC Online 347] and held that requirement of obtaining EC is mandatory by the industrial units or they have to pay compensation for the period they function without EC. The NGT in this case *Dastak NGO* v. *Synochem Organics Pvt. Ltd. & Ors.* [Order dated 3 June 2021] also ordered the relevant authorities to take appropriate action against the Respondent entity in accordance with polluter pays principal.

Liquidation of corporate debtor based on sole decision of related part Financial Creditors not correct

NCLT Kolkata Bench had initiated liquidation proceedings against the Corporate Debtor based on the majority decision taken by the Committee of Creditors (COC). The Appellant, being the representative of employees of the Corporate Debtor contended that the COC consisted of two such companies which were managed and owned by one of the Directors of the Corporate Debtor who resigned after the initiation of Corporate Insolvency Resolution Process, thus making them related parties, and these companies constituted majority (vote share of 77.20%) of the total Financial Creditors/ COC. NCLAT observed that, by allowing the related parties to be on COC and holding majority of voting shares, the Resolution Professional has not acted in an impartial manner. The Principal Bench also held that the entire process before the COC was vitiated and was a nullity in the eyes of law. Observing that the Corporate Insolvency Resolution Process (CIRP) process of Corporate Debtor was in totally disregard of the Insolvency and Bankruptcy Code, 2016 ("**Code**"), the NCLAT in *Jayanta Banerjee* v. *Liquidator of INCAB Industries Ltd.* [Judgement dated 4 June 2021] quashed the impugned order of liquidation passed by NCLT Kolkata Bench. The Bench also ordered restoration of the original petition filed under Section 9 of the Code against the Corporate Debtor.

Review of the regulatory framework of promoter, promoter group and group companies as per SEBI (ICDR) Regulations, 2018 on cards

SEBI has issued a Consultation Paper proposing to make certain amendments pertaining to the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018. The paper issued on 11 May 2021 seeks comments on reduction in the lock-in period for minimum promoter contribution, rationalization of the definition of 'Promoter Group', streamlining

disclosures of group companies, and shifting from the concept of 'promoter' to 'person-in-control'.

Regulations pertaining to debt securities and non-convertible redeemable preference shares to be merged

SEBI has sought public comments on the review and merger of SEBI (Issue and listing of Debt Securities) Regulations, 2008 and SEBI (Issue and Listing of Non-Convertible Redeemable Preference Shares) Regulations, 2013 into a single regulation to be known as the SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021. As per reports, the move will reduce the compliance burden on listed entities.

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