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Centre for Corporate Law

MONTHLY CORPORATE LAW UPDATES (OCTOBER, 2021)

-INSOLVENCY AND RESTRUCTURING LAW

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INSOLVENCY AND RESTRUCTURING LAW

JUDGEMENTS

1 Personal Guarantor can be proceeded against even without the Corporate Debtor undergoing CIRP [PNB Housing Finance Ltd. Vs. Mr. Mohit Arora (MD of Supertech Ltd.)]

In a contract of guarantee, the personal guarantor is as liable to the creditor as the debtor is. It is commonly referred to as the principle of co-extensiveness. In case a debtor defaults, even the personal guarantor can be subjected to insolvency proceedings. In this regard, a doubt may arise as to whether the insolvency can be initiated against the personal guarantor without first proceeding against the corporate debtor.

This was clarified by NCLT Delhi. The tribunal stated that the term 'Personal Guarantor' as defined in the relevant rules does not require the corporate debtor to be undergoing CIRP. The personal guarantor is duty-bound to pay the defaults of the corporate debtor.

Furthermore, the court said that insolvency proceedings can be initiated against the CD and personal guarantor simultaneously. This was a fair reiteration of the already settled law in this regard.

Order available here.

2 Claims of the GST Department cannot be edited or reduced by the Resolution Professional [Bijoy Prabhakaran Pulipra vs. State Tax Officer (Works Contract), SGST Dept., Kerala]

The Insolvency and Bankruptcy Code 2016 (IBC) gives the IRP/RP the power to make decisions regarding the resolution of the Corporate Debtor (CD). Such powers include revising and updating the claim amount of the creditor. This power can also be exercised when the amount is not precisely determined. However, concerns might arise about the sacrosance of such powers. A similar issue arose where the question was whether the RP has the power to revise the amount concerning GST.

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NCLAT Chennai stated that the GST amount that is levied as tax, is an amount levied under the Goods and Services Tax Act 2017 (GST ACT). The power to collect this amount is with the GST Officials. The tribunal stated that the GST amount cannot be reduced or edited by the RP as this is an adjudicatory power, whereas the revision powers of the RP is limited to cases of impreciseness and contingencies. By exercising such judicial powers, the RP would be in breach of the powers set out in the IBC.

This judgement clarifies several concerns about the transaction between tax authorities and the RP.

Order available here.

3 Security Deposit and interest attached to it is considered as a 'Financial Debt' under the IBC [Sach Marketing Pvt. Ltd. vs RP of Mount Shivalik Industries Ltd.]

A Security deposit is a sum of money given as a proof of intent to enter a transaction. It serves as a security measure for the person to whom it is given. There is a type of security deposit which is given along with an interest attached to it. This interest is paid in a time-bound manner. In this regard, doubts may arise as to whether such security deposits accompanied by interest qualifies as a 'Financial Debt' as per the IBC.

This was clarified by NCLAT Delhi. The tribunal stated that the definition of 'Financial Debt' in the relevant provisions of the IBC stipulates that a debt is a 'Financial Debt if it is disbursed against consideration for time value of money, and it has the commercial effect of borrowing. In this case, the 'Security Deposit' mentioned in the MoU between the parties mandated a time-bound consideration by way of 21% annual interest to be paid. Looking at this, the tribunal stated that this debt qualifies both the conditions of the definition under the IBC and this debt has the 'commercial effect of borrowing'.

Order available here.

INSOLVENCY AND RESTRUCTURING LAW

4 Operational Creditors can be further classified for the payment of dues and it does not violate 'Equality' [Gail India Ltd. vs Ajay Joshi, Resolution Professional of Alok Industries Ltd.]

Perhaps the most controversial provision under the IBC is Section 53 which provides for the mechanism in which the proceeds of liquidation would be distributed amongst the creditors of a CD. An approved resolution plan cannot provide for a sum to be given to a creditor which is less than the amount the creditor would've received during liquidation. Beyond the liquidation amount any amount that is paid to creditors is at the mercy of the commercial wisdom of the CoC.

In the present case, while the liquidation value to be received by operational creditors was NIL, the resolution plan still allocated a certain amount towards the payment of dues of those 'Operational Creditors', whose admitted claims were up to Rs.3 lakhs. While the resolution applicant claimed the acceptance of this allocation to be a bonafide exercise of the 'commercial wisdom' of the 'Committee of Creditors', the appellant challenged the Resolution Plan on grounds of arbitrary discrimination. The pivotal contention observed by NCLAT Delhi was pertaining to the discrimination among the Operational Creditors in payment of dues.

It was held by the tribunal that 'equality concept' would be not be violated if operational creditors are further classified for the purposes of payment. Additionally, the CoC have the final discretion as a part of their 'commercial wisdom'. The classification they make is based on two factors. Firstly, the amount to be paid overall and secondly, the quantum of money to be paid to the sub-category of operational creditor. Hence, classification can be done and there is no violation of equality in this regard.

Order available here.

SECURITIES LAW

CIRCULARS

1 SEBI released revised formats for limited review and audit report for issuers of non-convertible securities

Non-banking financial companies (NBFCs) are financial institutions that offer various banking services like loans, acquisition of marketable securities, leasing, hire-purchase, insurance. Banks and institutions like NBFCs issue non-convertible securities (NCS). These securities are the financial instruments used by companies to raise long-term capital which is done through a public issue.

While any public issue entails layers of disclosures, through this circular SEBI revised formats for limited review and audit reports to be submitted by entities that have listed their NCS. As a part of disclosures, entities need to produce limited review and audited reports for their standalone as well as consolidated financial statements.

Standalone financial statements report the activities of only parent company as a single entity and do not include the performance of its subsidiaries. Consolidated financial statements report all activities of a company and its subsidiaries as a combined entity. These financial statements help the investors to determine the health of a company.
The previous regulation required the submission of standalone financial statements, bi-annually and consolidated financial statements annually. However, the markets watchdog has increased the frequency of filing standalone financial statements through the amendment. From the earlier bi-annual submission, a quarterly submission is to be made.

The objective through the revised formats is to obtain reasonable assurance about whether the standalone and consolidated financial statements as a whole are free from material misstatement (fraud or error), and to issue an auditor's report that includes opinion. Further, the increase in frequency of filing the reports will bring more clarity to investors about the hygiene of the business.

Circular available here.

SECURITIES LAW

2 SEBI enhances grievance redressal system to benefit clients

SEBI endeavours to redress grievances to protect investors' interests. Investors can primarily approach the listed company file a complaint in case of a grievance. Should the redressal be unsatisfactory, they could approach the Investor Grievance Redressal Committees (IGRCs) of BSE or NSE.

This body acts as a mediator to resolve investor claims. If faced with yet another unsatisfactory response, investors could opt arbitration. However, these arbitrations could be long-drawn and without any immediate relief. To further enhance the system, SEBI has recently brought an amendment to its Investor Grievance Redressal System ("IGRS") and Arbitration Mechanism.

The amendment directs that client getting favourable orders against market operators will be compensated even if the process goes into arbitration.

SEBI specifies that the claim value admissible to the clients should not exceed Rs 20 lakh. The money under this claim is to be released to the client from the investors protection fund (IPF) of the stock exchange. The clients would receive 50 per cent of the claim value or Rs 2 lakh, whichever is less.

This amendment will prevent unnecessary arbitration and quicker settlement of grievances.

Circular available here.

SECURITIES LAW

PRESS RELEASE

1 Registered Investment Advisers cannot provide for advise in unregulated products such as Digital Gold

Registered Investment Advisers (advisers) are finance professionals who make investment recommendations by analysing the performance of securities. In this light, the Securities Contracts (Regulation) Rules, 1957 (SCRR) prescribes certain securities under the definition of securities. However, digital gold is not prescribed under such definition. The instruments defined as securities under the SCRR are regulated and instruments such as digital gold, cryptocurrency that do not come under the definition of securities, are unregulated products.

Despite digital gold's existence in the regulatory grey area, SEBI noticed that certain Advisers are engaged in advisory, distribution and implementation services in digital gold. In this regard, the SEBI's recent press release directed advisers to refrain from dealing in unregulated products. Doing so may entail action by SEBI.

Press release available here.

REGULATIONS

1 Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) (Fourth Amendment) Regulations, 2021

Promoters are infamous for their chequered past. Right from oppressing minority shareholders to committing fraud on investors, they have done it all. Due to these issues, SEBI in 2009 had prohibited the issuance of shares with superior voting rights (SR shares) to promoters. However, through recent amendment to the SEBI (Issue of Capital and Disclosure Requirements) Regulations, SEBI eased the eligibility criteria relating to SR shares. While an ordinary share operates on the principle of "one share, one vote", an SR share offers a maximum of ten votes.

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In this regard, SEBI has eased two criteria pertaining to superior voting rights. First, concerning promoters' net worth considerations and second, the issue surrounding the lock-in period of holding SR Shares before the filing DRHP.

- **Net worth considerations**

The earlier regime mandated that the SR shareholder shall not be part of a promoter group whose collective net worth is more than 500 crores. The ICDR Regulations provide a broad definition of promoter and promoter group. Such definition includes large set of relatives or entities. Further, the matter gets complicated in case of multiple promoters. Therefore, the amendment proposes determining net worth considerations on individual basis from the earlier promoter-group inclusion. Moreover, the net-worth requirement has been enhanced from the earlier Rs 500 crores to 1000 crores.

Therefore, the new regime enables individual promoters with a net worth of over 1000 crore with SR shares in their companies.

- **Lock-in period before filing DRHP**

In the earlier regime, promoters were to hold SR shares for a period of at least 6 months before the filing of the Draft Red Herring Prospectus (DRHP). SEBI has reduced this lock-in period identifying the delay caused to the issuer in raising funds from the capital market. In this light, the amendment reduces the lock-in period to 3 prior to the filing of the DRHP from the earlier 6 months.

While SEBI has relaxed the eligibility criteria for SR Shares, a pertinent question props up – "whether providing SR shares to promoters would compromise investor interests?". While protecting shareholders is essential, promoters constitute the idea of any start-up. Promoters of new age companies have vision to take the company forward however lack on the capital front. Shares of promoters undergo significant dilution with raising capital. However, control is quintessential to growth of a business.

SECURITIES LAW

In this light, these relaxations concerning differential voting rights seek to encourage start-up founders to list their business. It empowers the promoters with greater voting rights despite lower shareholding. Therefore, issuing these shares to promoters would protect the idea behind the company. Protection of this idea would lead to business growth in turn would develop in the growth of its shareholders.

Regulation available here.

COMPANY LAW

CIRCULARS

1 MCA extends the deadline for filing Form 8 (Statement of Account and Solvency) by LLPs up to 31st December 2021, without paying any additional fees

Limited Liability Partnership (LLP) is a form of business entity, providing benefits of partnership firm and private limited company in one frame. LLPs are required to file form 8 on an annual basis. Form 8 is a statement of account and solvency, declaring the financial position at end of the year. It includes information concerning details of all the financial transactions undertaken by the LLP. As per rule 24(4) of the Limited Liability Partnership Rules 2009, Form 8 has to be duly filled by LLPs before October 30th of every year. A penalty of Rs.100 per day is imposed on failure to comply with the deadline.

In this regard, MCA has extended the deadline of filing Form 8 (statement of account and solvency) for the financial year 2021-22 up to 30th December 2021. The extension was granted on the account of challenges faced by LLPs during the pandemic. Further, MCA has notified that the LLPs can file form 8 up to the conditioned deadline without paying any additional fees.

Order available here.

2 MCA extends the due date of filing the Cost Audit Report to the Board of Directors

A cost audit is a critical review undertaken by cost auditors to meet a two-fold objective. First, to examine the veracity of the cost accounts of a company, and second, to scrutinize whether the statutory procedure pertaining to accounting is complied with. The Companies (Cost Records and Audit) Rules mandate that every auditor must furnish the cost audit report to the Board of Directors within 180 days from the date of closure of the financial year.

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While 30 September 2021 marked the completion of 180 days from the financial year, MCA through an order last month extended the due date up to 31 October 2021.

Through a recent order, MCA has further extended the date till 30th November 2021. The extension was granted in the wake of the representations made by the audit fraternity. The representations highlighted the inability to submit the report within the stipulated time owing to the turbulent impact of COVID-19.

Order available here.

ARBITRATION LAW

JUDGEMENTS

1 Arbitrators are not allowed to grant pendente lite interest when contractual clauses bar the same: Supreme Court [Garg Builders v. Bharat Heavy Electricals Ltd.]

Interest, in most basic terms, means the amount charged on the money lent, at a particular rate of interest. Pendente lite interest is the interest that keeps on adding to the base amount, during the pendency of any money matter. As per the provisions of the Arbitration Act, an arbitrator can grant interest only if the contract does not provide otherwise.

In this regard, parties in the present case entered into a contract that consisted of interest barring clause. The clause provided that no interest shall be payable by the party on various deposits or money. However, the arbitrator granted pendente lite interest to the party. The question arose before the court that whether an arbitrator can grant pendente lite interest when the contract provides otherwise.

To this, the Supreme Court while deciding the matter observed that the provisions of the Arbitration Act give overriding importance to contractual terms. The court further stated that the Arbitration Act provides granting of interest only when parties have not agreed upon non-payment of interest in the contract. Hence, such an award violates this relevant provision of the act. Thus, the Apex court held that an arbitrator is not open to granting pendente lite interest when the parties have agreed on the contrary, in the contract.

Judgment available here.

ARBITRATION LAW

2 In an application to set aside an arbitral award, depositing 75% of the awarded amount as pre-deposit amount under the MSME Act is mandatory: Supreme Court [Gujarat State Disaster Management Authority v. Aska Equipments Limited]

While the Arbitration Act is a general statute that consolidates laws relating to arbitration, the MSME Act as well, incorporates arbitration as a mode of dispute resolution. In arbitration, setting aside an arbitral award means rejecting the decision of an arbitration proceeding as invalid. In an application to set aside an arbitral award, where parties are governed by the MSME act, a pre-deposit of 75% of the already awarded amount is required.

In the present case, one of the parties failed to provide the pre-deposit amount. Therefore, the question before the court was that whether the court has the discretion to grant relaxation from the requirement of pre-deposit amount.

In this regard after relying on similar previous cases, the court was of the view that in an application to set aside the arbitral award under the Arbitration Act, where the MSME act is specifically related, the requirement of depositing 75% of the awarded amount is mandatory.

The court rejected that the court has any discretion to diverge the provision. Additionally, the apex court observed that if the court in certain circumstances is satisfied that there is hardship caused to the applicant to deposit the conditioned amount, the court may allow pre-deposit in installments.

Judgment available here.

ARBITRATION LAW

3 Arbitrator has substantial discretion in awarding interest under Sec 31(7)(a) Arbitration Act: Supreme Court (Punjab State Civil Supplies Corporation Limited (PUNSUP) vs. Ganpati Rice Mills)

The Supreme Court of India ("Supreme Court"), in the present case was dealing with an Arbitration Appeal in re the quantum and the time-period for which interest was for awarded by an arbitrator. The concerned arbitrator had awarded interest at the rate of 18% per annum till the date of realization. This included both pendente lite and future interest. A Section 34 petition was filed before the District Court at Chandigarh, wherein the learned judge reduced the rate of interest to 12%.

The first appeal to this decision of the District Court was preferred before the Punjab and Haryana High Court. The High Court, relying on the Supreme Court's judgement in the case of A.P. State Trading Corporation Ltd. Vs. G.V. Malla Reddy and Company reduced the rate of interest to 9%. The aforementioned judgement had held that the absence of any specific contract regarding rate of interest, pendente lite, and future interest should not normally exceed 9% per annum.

The matter finally reached the Supreme Court where it has now been clarified that "Section 31 (7) of the Arbitration Act, 1996 grants substantial discretion to the arbitrator in awarding interest". The Court, therefore, set aside the decision of the High Court, for the decision was not based upon the correct principles of law, and no reason and grounds were provided for reducing the rate of interest. The Supreme Court also disapproved the reliance on the A.P. State Trading Corporation case as the same was given in the context of the Arbitration Act 1940. Finally, considering the fact that the decision of the District Court vis-à-vis the reduced interest of 12% was accepted by the concerned party, the Supreme Court restored the rate of interest at 12%.

Judgement available here.

ARBITRATION LAW

4 Arbitral Tribunal cannot pass ex-parte ad-interim order; Arbitration Act mandates advance notice: Bombay High Court (Godrej Properties Ltd V/s. Goldbricks Infrastructure Pvt. Ltd.)

An ex parte order is an order passed in the non-appearance of the opposition. The High Court in the present case was dealing with the impugned ex-parte order passed by the arbitral tribunal. The issue which arises for consideration was whether the learned arbitrator was right to pass an ex-parte ad-interim order under the application submitted by the respondent referring to Section 17 of the Arbitration and Conciliation Act.

In the present case, the order passed by the sole arbitrator was in Goldbricks' favor, restraining Godrej without hearing either party. Godrej claimed that since both the parties were already before the tribunal they should have been heard. Further argued that Goldbrick didn't pray for an ex-parte ad-interim order and only asked for a date of hearing.

On the other hand, Goldbricks Infrastructure came in support of the arbitrator as well as the impugned order passed by the arbitral tribunal. It also contended that the application under section 17 was necessary. It was necessary so that order passed by the tribunal in the future will not be yielded as a "paper award".

The High Court observed that the parties need fair treatment, need to agree on a procedure followed by the tribunal, distinguishing it from the court, and mandates that all parties 'shall be given sufficient advance notice of 'any hearing'. The High Court held that the proviso which deals with the Court's power to pass ex-parte orders, cannot be applied to arbitral proceedings.

Judgement available here.

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