NATIONAL LAW UNIVERSITY ODISHA

सत्ये स्थितो धर्मः

Centre for Corporate Law

MONTHLY CORPORATE LAW UPDATES (AUGUST, 2021)

-INSOLVENCY AND RESTRUCTURING LAW

-SECURITIES LAW

-COMPANY LAW

ccl.nluo.ac.in

INSOLVENCY AND RESTRUCTURING LAW

ORDERS

1 NCLAT allows sale of Corporate Debtor as a going concern under Liquidation [M/s. Mohan Gems & Jewels Pvt. Ltd. Through its Liquidator Debashish Nanda Vs. Vijay Verma – NCLAT New Delhi]

The NCLAT has settled the dust on the issue as to whether the Liquidator can sell the Corporate Debtor as a going concern via the Liquidation Process. In ruling that the Corporate Debtor cannot be sold off as a going concern by the Liquidator, the Adjudicating Authority neglected the numerous decisions of the Supreme Court wherein it has been held that the liquidation of a Corporate Debtor is supposed to be the last resort and every attempt must be made to continue the Corporate Debtor as a going concern. The Appellate Authority while setting aside the abovementioned judgement, relied upon the scheme of the Code which prescribes that the Code is an "economically beneficial legislation" which seeks to "maximize the value of assets of the Corporate Debtor". Further, the Appellate Authority keeping in view the scope and spirit of the Code, read with Section 54 of the Code, Regulation 39C of CIRP Regulations, Regulations 32(e)&(f), 32A and 45(3) of the Liquidation Process Regulations, ruled that the Corporate Debtor or its business can be sold off a going concern.

(Order available here)

INSOLVENCY AND RESTRUCTURING LAW

2 Preferential Transaction under Section 43 of the IBC reversed by the Appellate Authority [M/s. Kushal Traders Vs. Mr. T.V. Balasubramanian RP of Sholingur Textiles Ltd.]

The management of a company is usually aware about the future financial situation of the company and can reasonably presume if the company in question might face insolvency in the near future. In such a situation, the management might try to dispose of the assets of the company or rearrange liabilities in order to obtain benefit illegally. Avoidance proceedings seek to reverse the effect of such transactions and return the assets of the Corporate Debtor undergoing CIRP.

In furtherance of developing the jurisprudence with respect to avoidable transactions, the NCLAT Chennai has passed an order declaring a sale to be a preferential transaction and subsequently reversed the transaction. The Corporate Debtor in the instant case tried to settle the dues of a creditor by way of executing a sale deed dated 04.07.2018 amounting to a sum of Rs. 1,69,07,250/-. An application for the initiation of CIRP was filed against the Corporate Debtor was admitted on 04.05.2019. The Resolution Professional appointed analyzed the transactions having taken place during the lookback period and reported the abovementioned sale before the Adjudicating Authority. The question before the Adjudicating Authority was whether the sale deed dated 04.07.2018 is a preferential transaction as under Section 43(1) of the IBC. When the order of the Adjudicating Authority was challenged before the Appellate Authority, the NCLAT reaffirmed the decision of the NCLT while analyzing the elements of an avoidable transaction interalia the effect of the transaction in question.

(Order available here)

INSOLVENCY AND RESTRUCTURING LAW

3 During simultaneous CIRPs against Co-Borrowers the recovery under one CIRP can be deducted during the second CIRP to avoid multiplicity of claims [Maitreya Doshi Ex-Director of Doshi Holdings Pvt. Ltd. Vs. Anand Rathi Global Finance Ltd.]

While there is no bar on a creditor to proceed against the co-borrowers simultaneously, the question with respect to the quantum of money to be received by such borrowers was yet to be decided. In a view to settle this conflict, the NCLAT has passed an order whereby in a situation a creditor extends credit facilities to joint borrowers, the amount received under one CIRP can be taken a note of and can be deducted from the claim in the second CIRP. This will go a long way in preventing creditors to take an advantage of the simultaneous CIRPs and will not put them at an advantageous position as compared to others.

(Order available here)

AMENDMENTS AND NOTIFCATIONS

1 Central Government notifies the Insolvency and Bankruptcy Code Amendment Act, 2021 enabling Pre-packaged Insolvency Resolution for MSMEs

Introduced in July, 2021 in the Lok Sabha, the much-awaited bill has finally received assent by the President. The salient features of the amended act include an alternate insolvency resolution process called the Pre-packaged Insolvency Resolution Process (PIRP) for Micro, Small and Medium Enterprises (MSMEs) with defaults not more than Rs 1 crore.

INSOLVENCY AND RESTRUCTURING LAW

PIRP is a model that allows the Promoters of the Corporate Debtors (CDs) to provide a base resolution plan and resolve their outstanding debt without having to stop the operations of the business. The management of the affairs of the corporate debtor shall continue to vest in the Board of Directors or the partners, as the case may be, of the corporate debtor. The Board of Directors shall make every endeavour to protect and preserve the value of the property of the corporate debtor, and manage its operations as a going concern. The promoters, members, personnel and partners, as the case may be, of the corporate debtor, shall exercise and discharge their contractual or statutory rights and obligations in relation to the corporate debtor.

Under this process, the CDs are to seek approval for the plan from the the committee of creditors for submission. The resolution professional shall submit the resolution plan as approved by the committee of creditors to the NCLT. This is also a relief for the NCLT because they are now only required to approve or reject the plan.

Interestingly, PIRP is not a new concept. It is one of the increasingly popular insolvency resolution systems in the UK and Europe. The need for this system in India was based on the fact that the Corporate Insolvency Resolution Process (CIRP) was found to be a lengthy and cost-driven insolvency resolution process leading to large chunks of cases being pending before the NCLT. Unlike CIRP which requires the process to be complete within 330 days of the initiation of the proceedings, PIRP is limited to a maximum of 120 days with only 90 days available to the stakeholders to bring the resolution plan to the NCLT.

The modified act is promising in nature for MSMEs, intending to provide them with market opportunities while also addressing any issues with liability. The act also includes provisions to ensure proper implementation and management of any fraudulent act by corporate debtor during pre-packaged insolvency resolution process to evade making payments to creditors. The benefits of the act's implementation will be determined over time.

(Notification available here)

INSOLVENCY AND RESTRUCTURING LAW

2 IBBI seeks public comment on the issues related to CIRP

In a discussion paper released by the IBBI, comments are invited for the issues concerning the 'conduct' of Committee of Creditors (CoC). It discusses on the restrictions on request for resolution plans, the use of swiss challenge; and treatment of live bank guarantees (BGs) and line of credit (LCs) as claims. They have been elaborated herein:

Firstly, the IBC, 2016 envisages market led solutions in the insolvency space driven by various stakeholders such as insolvency professionals, and CoC. During a CIRP, the CoC is vested with a duty of trust and care. CoC has to take important decisions on several matters impacting CD and associated stakeholders. Hence, it is a matter of grave concern to device an appropriate professional code of conduct to meet the objectives of the IBC, 2016. The paper proposes a code of conduct based on broad principles to ensure transparency in the insolvency process and circumscribe the decision making power of the CoC even though they act as the supreme stakeholder with commercial wisdom in any financial decisions under the IBC, 2016.

Secondly, the paper also deals with the issue related to request for revision of resolution plan (RFRP) multiple times, and submission of unsolicited plans causing delay and uncertainty and the idea of using challenge mechanisms such as the swiss challenge in the CIRP for value maximisation. Swiss challenges is a bidding process wherein an interested party(original bidder) initiates a proposal for a contract or the bid to the auctioneer. Once approved, the auctioneer then seeks counter proposals against the original bidder's proposal and chooses the best amongst all options. Considering the issue that there is no express prohibition on the adoption of Swiss challenge method during a CIRP the proposal is made to regulate the RFRP and usage of Swiss challenge subject to market conditions.

INSOLVENCY AND RESTRUCTURING LAW

Lastly, it also proposes to regulate the treatment of live BGs and LCs as claims which is invoked by the beneficiary during the CIRP. The contention is that since there is no direct right to payment for banks arising out of BGs/LCs given and the indirect right to payment arises only when the debtor defaults, thus, live BGs/LCs cannot be said to fall under the definition of "claims". The proposed amendment would help by removing ambiguity regarding rejection of claims pertaining to BGs/LCs. This would help enhance faith amongst stakeholders in CIRP.

The IBBI solicits public comments on the same by September 17,2021.

(Notification available here)

3 Income Tax Rules amended to align with the IBC, 2016

In a move to align the two laws i.e. the Income Tax Rules, 1962 and the IBC, 2016, the Central Board of Direct Taxes recently amended the Income Tax Rules. These rules concern the furnishing and filing of tax returns. The purpose of this amendment is to oblige the "Resolution Professional" to comply with the said Rules as an Authorised Representative of the Corporate Debtor. A "Resolution Professional" is appointed by the NCLT for the purpose of carrying out the insolvency resolution process. In cases of Liquidation, the liquidator would comply with the said rules.

(Notification available here)

SECURITIES LAW

ORDER

1 SEBI bars entities in Zee Insider Trading case

The illegal act of trading of a public company's securities on a stock exchange to one's own advantage, when in possession of confidential or non-public information, is Insider Trading. The said sensitive information is known as the Unpublished Price Sensitive Information (UPSI). Trading when in possession of UPSI is in contravention of the SEBI PIT Regulations.

In this regard, SEBI recently barred 15 entities, including executives from broking houses such as UBS, Edelweiss from the securities market. The entities were banned for indulging in insider trading in the stocks of Zee Entertainment Enterprises Limited (ZEE Ltd.) when in possession of UPSI.

SEBI's investigation revealed that Zee Ltd.'s employee Mr. Bijal Shah divulged the UPSI to Gopal Ritolia and Jatin Chawla, who then passed the UPSI to friends and relatives. In the present matter, the quarterly and annual financial results yet to be brought to public knowledge was treated as the UPSI. Based on the UPSI, the insiders purchased a large volume of shares of Zee Ltd, ahead of the public announcement of its quarterly and annual financial results.

SEBI's extensive investigation uncovered that the insiders used accounts of their mothers and other relatives to execute the trade. The investigation involved scanning trading accounts, social media handles, bank details and call records of the insiders.

(Order available here.)

SECURITIES LAW

REGULATIONS

1 SEBI (Listing Obligations and Disclosure Requirements) (Third Amendment) Regulations, 2021

Independent Directors (IDs) are non-executive directors who possess no material relationship with the Company. Enabling higher governance standards, IDs assume the role of a guide. However, the independence of IDs has always been an issue of grave concern. The development assumes significance in the backdrop of the role of IDs coming under scrutiny for their failure in detecting and preventing corporate frauds and promoter mismanagement.

As a consequence of an ID's limited powers in a company, Corporate Governance is hindered. In this regard, SEBI introduced an amendment into the (Listing Obligations and Disclosure Requirements) Regulations, 2015. The amendment seeks to bolster the framework pertaining to IDs.

The Amendment aims to empower regulations governing IDs to meet the greater objective of transparency, fair disclosures and in turn Corporate Governance by listed entities. The key amendments are as follows:

-The appointment, re-appointment and removal of IDs

Earlier, the process of appointment/re-appointment/removal of IDs was passed by a General Meeting of Shareholders. However, this set-up propagated promoter dominance in turn, hindering smooth Corporate Governance. In this regard, the Amendment mandates a mechanism of special resolution by the shareholders for appointment/re-appointment/removal. This would achieve a two-fold objective for the furtherance of Corporate Governance.

SECURITIES LAW

First, the appointment/re-appoint/removal of IDs would be backed by the voice of the institutional other public shareholders and second, would safeguard the appointment or removal of IDs at the perusal of promoters.

-IDs to approve Related Party Transactions

Another impediment for effective Corporate Governance is the conundrum of Related Party Transaction (RPT). Previously, an Audit Committee constituted by Directors approved RPTs. However, due to lack of independence in the audit committees in companies, India has witnessed several scams such as Sahara and Satyam. The amendment brings forth a change in the scenario, bestowing the responsibility of approving RPTs solely upon the IDs. An IDs independence would mitigate scenarios of scams in the name of RPT.

Due to concerns around the efficacy of IDs as a part of corporate governance framework in the previous regulations, SEBI felt a need to reinforce the independence of IDs and enhance their effectiveness in protection of the interest of the minority shareholders and other functions.

(Regulation available here.)

CIRCULARS

1 SEBI Allows Mutual Funds to Maintain Accounts in Many Banks

As a matter of practice, Mutual funds maintained current accounts in multiple banks including banks having presence beyond top 30 cities. The arrangement met a two-fold objective. First, it enabled investors to transact with banks of their choice and second, it bolstered the facilitation of faster transfer of funds.

SECURITIES LAW

However, a conundrum arose among the Mutual Fund industry with the introduction RBI's Circular named 'Opening of Current Accounts by Bank - Need for Discipline'. The said RBI Circular directed banks to freeze or close accounts of customers that had availed credit facilities earlier in the form of Cash Credit (CC) or Over Draft (OD) from other banks. RBI's objective pertaining to this circular is in two-fold. First, it appears that the central bank wants to regulate and keep track of all CC and OD facilities availed by customers. Second, it also wants banks to maintain records of bifurcation of the working capital facility into loan and cash credit component.

Clarifying the conundrum, the market's regulator reiterated that mutual funds are required to maintain current accounts in appropriate number of banks for the purpose of subscription amount. SEBI highlighted that such a set-up would facilitate financial inclusion of investors and enable ease of doing business.

(Notification available here.)

2 Requirement of minimum number and holding of unit holders for unlisted Infrastructure Investment Trusts (InvITs)

Infrastructure Investment Trusts (InvITs), enable direct investment of small amounts of money from probable investors, to earn a small portion of income as return. In Indian, InvITs are governed by SEBI (Infrastructure Investment Trusts) Regulation, 2014.

A recent amendment to the regulations provides for the requirement of minimum number of unit holders for unlisted InvITs. In light of this, SEBI reiterated that the minimum number of unit holders in an InvIT other than sponsors and its related parties and associates should be five and collectively holding at least twenty-five per cent of total units of the InvIT at all times.

(Notification available here.)

COMPANY LAW

AMENDMENTS

1 Foreign companies and companies incorporated outside India exempted from Sections 387 to 392

Chapter XXII of the Companies Act enshrines the provisions dealing with companies incorporated outside India. The newer 393A had been inserted to provide exemptions to foreign companies along with companies that were incorporated outside India, from the earlier sections of the chapter i.e., Section 387 up to 392. They include dating of prospectus and provisions as to experts' consent and allotment; the registration of prospectus; offer of India depository receipts; and the punishment for contravention of the aforementioned provisions.

(Notification available here)

2 Companies (Specifications of definitions details) Third Amendment Rules, 2021: Definition of electronic mode

This amendment has sought to refine the phrase 'electronic mode'. It construed that the electronic-based offering of securities, subscription thereof or listing of securities in the International Financial Services Centres shall not fall within the category of electronic mode under the Act. The purpose of this amendment is to exclude the electronic presence of a foreign company in the IFSC from definition of Foreign Company in the Act.

(Notifications available here)

CONTRIBUTORS

ANJALI SONI

ARSHIT KAPOOR

MANISHA GUPTA

SANSITA SWAIN

SHACHI GAMBHIR

SOUJANYA RAMASWAMY

Centre for Corporate Law - National Law University Odisha

The Centre for Corporate Law, as it is called, is an initiative to promote interdisciplinary...

CCL