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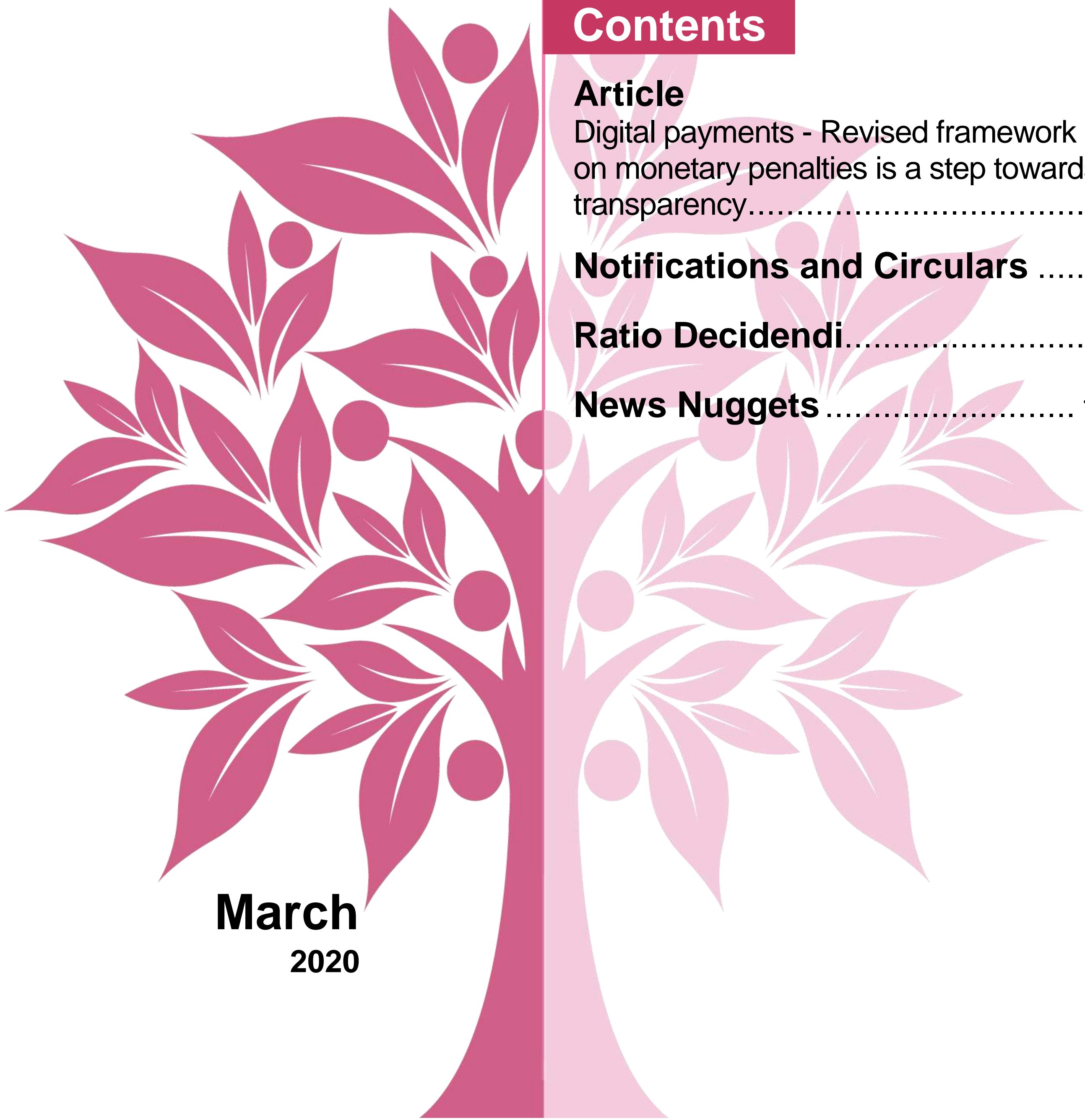
Contents

Article
Digital payments - Revised framework on monetary penalties is a step towards transparency.................................. 2

Notifications and Circulars 4

Ratio Decidendi......................... 9

News Nuggets 13



March
2020

Article

Digital payments - Revised framework on monetary penalties is a step towards transparency

By **Kumar Panda**

Introduction:

India has seen rapid advancement in the FinTech industry in the last couple of years leading to increased number of transactions, entry of number of non-banking players, availability of multiple online payment modes, etc. This evolving sector is majorly regulated by the Reserve Bank of India by way of issuance of guidelines, directions, policies, instructions from time to time. For example, an important policy decision of recent times - the storage of payment data in a system only in India was implemented by RBI as a directive dated 06th April 2018. RBI penalises non-compliances of such regulatory directions by levying monetary penalties which in the last 18 months resulted in penalties ranging from INR 0.5 million to INR 30 million on wallet providers, prepaid instrument providers and payment app providers.

Payment and Settlement Systems Act 2007:

RBI derives such powers to regulate payment systems and payment system participants by way of directives, guidelines from the Payment and Settlement Systems Act 2007 ("**PSS Act**"). Under the PSS Act, the RBI is designated as authority for regulation and supervision of payment systems, payment system participants in the country. Payment systems and system participants regulated by PSS Act include debit and credit card providers, banks, UPI, IMPS, NETC (FASTags), payment gateways, digital wallets, prepaid payment instruments like employee meal vouchers.

Offences and Penalties under PSS Act:

Chapter VII (Sections 26 to 31) of the PSS Act deals with penalties and offences. Section 26 of the PSS Act deals with offences, which are punishable with imprisonment or fine or both. An indicative list of offences by payment systems and payment system participants under Section 26 as provided by RBI includes non-compliance of AML/KYC norms, breaching data localization norms, breach of limits in loading prepaid cards, non-maintenance of minimum net worth, non-maintenance of outstanding balance in an escrow account by a prepaid instrument provider.

In addition to Section 26, Section 30 empowers RBI to impose penalties where payment system provider makes a false statement or wilfully omits to make a material statement or any provision of PSS Act is contravened, or if any default is made in complying with any regulation, order or direction made or given or condition imposed thereunder and in respect of which no penalty has been specified.

In the background, RBI in the year 2016 issued Framework for imposing monetary penalty on Authorised Payment Systems Operators / banks under Payment and Settlement Systems Act, 2007 ("**Old Framework**") to offer a procedural guidance on levy of penalties and compounding under the PSS Act. The Old Framework was replaced recently by the RBI

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vide Circular dated 10th January 2020 ("**New Framework**").

Key Highlights of the New Framework:

1) **Introduction of objective methodology to determine the materiality of contravention and determining the amount of penalty**: The New Framework introduces an objective methodology to determine the materiality of the contravention which includes the i) severity of contravention in terms of degree of breach of norms/limits; ii) period and frequency of a similar contravention during the past 5 years; iii) seriousness of the contravention; iv) percentage of amount involved in the contravention vis-à-vis total value of transactions handled by the contravener during the period under consideration; and v) Amount involved in the contravention.

   For determining the amount of penalty, the amount of gain or unfair advantage, wherever quantifiable, accruing to the contravener as a result of the contravention; amount of loss caused to any other authority/agency/exchequer and/or to any other market participant; and the monetary benefits accruing to the contravener from delayed/non-compliance will be taken into consideration.

2) **Amount of Penalty**: The upper limit of Rs. 1 crore for non-quantifiable contravention under the Old Framework has been now brought down to Rs. 5 lakh per contravention.

3) **Requirement of a speaking order**: The New Framework makes it mandatory for the designated authority to issue a speaking order while levying penalties by taking into consideration all information and documents submitted by the contravener.

4) **Compounding:** The New Framework states that all offences mentioned in Section 26 of PSS Act (except those where a willful wrong statement is made in an application for authorization or in any return) can be compounded. The designated authority is now required to pass an order within a period of 6 months from the date of receipt of the complete compounding application.

5) **Payment of monetary penalty and disclosures:** The monetary penalty shall be payable within a period of thirty days from the date of the order. In case of failure in payment of penalty amount, RBI will initiate appropriate action against the contravener as per the PSS Act for recovery of the penalty. The entities are required disclose the details of monetary penalty paid under PSS Act in their Notes to Accounts that are part of Annual Financial Statements for the financial year in which the penalty is levied.

Conclusion:

Given the rapid growth in the FinTech industry in the past couple of years, the number of entities that are required to comply with the PSS Act, regulations and guidelines issued thereunder have significantly increased. By issuance of this Framework, RBI has voluntarily clipped its own wings from exercising the wide discretionary powers under the PSS Act which is a welcome move. The New Framework is also a step forward towards transparency in regulatory actions in a sector that is heavily regulated.

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Notifications and Circulars

Foreign Direct Investment in Insurance Sector revised: The Ministry of Commerce and Industry, Department of Promotion of Industry and Internal Trade, has reviewed the extant FDI Policy of 2017, as amended from time to time and allowed 49% FDI cap for Insurance Company under automatic route and 100% FDI cap for Insurance intermediaries under automatic route. As per Press Note No. 1 (2020) Series DPIIT File No. 5(1)/2020 dated 21st February 2020, the investment up to 49% of the total paid-up equity of Indian insurance company under automatic route shall be subject to the approval of Insurance Regulatory and Development Authority of India and in compliance of the provisions of the Insurance Act, 1938 and Indian Insurance Companies (Foreign Investment) Rules, 2015. The Indian Insurance Company is always required to ensure that that its ownership and control remain in the hands of resident Indian entities. The aggregate foreign investment including the investment by portfolio investors shall not exceed 49% of the paid-up equity of the Indian Insurance Company.

Takeover provisions under Section 230(11) and (12) of Companies Act, 2013 notified: The Ministry of Corporate Affairs has by Notification No. S.O. 525(E) dated 3rd February 2020 notified the provisions of Section 230(11) and (12) of the Companies Act, 2013 with effect from 3rd February 2020. Section 230(11) provides that any compromise or arrangement may include takeover offer in the prescribed manner and in case of listed companies, as per the regulations issued by the Securities and Exchange Board of India. Further, Section 230(12) empowers the National Company Law Tribunal to hear grievances and pass orders with respect to the takeover offer, other than listed companies. Further, it may be noted that consequential changes have also been made in the National Company Law Tribunal Rules, 2016 with effect from 3-2-2020.

Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 amended: The Ministry of Corporate Affairs has by Notification No. G.S.R. 79(E) dated 3rd February 2020 amended the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016. The amendments are in pursuance of the notification of Section 230(11) and (12) of the Companies Act, 2013. The amendments are as follows:

- Insertion of Rule 3(5), which states that any member along with any other member holding not less than three-fourths of the shares in the company, may make an application for arrangement for the purpose of takeover offer and such application shall be filed for acquiring any part of the remaining shares of the company. It has been clarified that the term “shares” means the equity shares of the company carrying voting rights and includes any securities, such as depository receipts, which entitles the holder thereof to exercise voting rights. Further, this rule shall not apply to any transfer/transmission of shares through a contract, arrangement or succession or any transfer made in pursuance of any statutory or regulatory requirement.
- Insertion of Rule 3(6), which specifies that an application of arrangement for takeover offer shall contain, (a) report of a registered valuer disclosing the details of the valuation of the shares proposed to be acquired by the member and (b) details of a bank account to be opened separately by the member wherein

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a sum of amount not less than 50% of total consideration of the takeover offer is deposited.

Exceptions/modifications/adaptations applicable to Government Company – Notification revised: The Ministry of Corporate Affairs has by Notification No. G.S.R. 151(E) dated 2nd March 2020 amended the previous Notification No. G.S.R. 463(E) dated 5th June 2015 specifying exceptions, modifications or adaptations applicable to the government companies. The amendments to the Notification are as follows:

- **Entry 1 - Explanation to Section 2(45)**: The term "paid-up share capital" shall be construed as "total voting power", where shares with differential voting rights have been issued.
- **Entry 1A - Section 4(1)(a)**: The reference to the public limited company and private limited company has been omitted.
- **Entry 26 - Section 188(1):** The first and second proviso to Section 188(1) specifies that a prior approval of the company by a resolution shall be needed to enter into transactions identified under Section 188(1) of the Companies Act, 2013 and no related party who is a member shall vote on such resolutions. These provisos shall not apply to government company in respect of contracts/arrangements entered with any government company or central/state government or any combination thereof. Further, these two provisos will also not be apply to an unlisted government company which obtains approval of the Ministry or department of the central/State government in charge of the company before entering into such contract/arrangement.

Independent Directors - Companies (Appointments and Qualifications of Directors) Rules, 2014 amended: The Ministry of Corporate Affairs has by Notification No. G.S.R. 145(E) dated 28th February 2020 amended the Companies (Appointments and Qualification of Directors) Rules, 2014. The amendments are in relation to compliances required by a person eligible and willing to be appointed as an independent director, which are as follows:

- The time period to apply online for inclusion of name in the data bank, after being appointed as an independent director in a company as on the date of commencement of the Companies (Appointment and Qualification of Directors) Fifth Amendment Rules, 2019, has been increased from 3 months to 5 months.
- It has been provided that an individual shall not be required to pass the online proficiency self-assessment test, if he/she has served as director or key managerial personnel, for not less than 10 years in listed public company, or unlisted public company having a paid-up share capital of Rs. 10 Crores **or a body corporate listed on a recognised stock exchange**, as on the date of inclusion in the databank.

Companies (Auditor's Report) Order, 2020: The Ministry of Corporate Affairs has by Notification No. S.O. 849(E) dated 25th February 2020 notified the Companies (Auditor's Report) Order, 2020. The Order shall be applicable to every company including a foreign company as per the provisions of the Companies Act, 2013 except a banking company, insurance company, not for profit (Section 8 of the Act) company, one person company, private limited companies not being a subsidiary of a public company having paid-up capital/reserves/surplus of not more than Rs. 1 crore and not having total borrowings exceeding Rs. 1 crore and total revenue

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exceeding Rs. 10 crores during the financial year. The Order specifies that matters that shall be contained in the Auditor's Report including a statement on the following matters:

- Records showing full particulars of property, plant and equipment, intangible assets etc;
- Physical verification of the property, plant and equipment by the management at reasonable intervals;
- Authentic and true disclosure of all the properties and title deeds held in the name of the company;
- Any proceedings pending/initiated against the company under the Benami Transactions (Prohibition) Act, 1988; etc.

Companies (Issue of Global Depository Receipts) Rules, 2014 amended: The Ministry of Corporate Affairs has by Notification No. G.S.R. 111(E) dated 13th February 2020 amended the Companies (Issue of Global Depository Receipts) Rules, 2014. The amendments are as follows:

- The scheme has been substituted by "Depository Receipts Scheme 2014" from "Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993".
- The term "overseas depository" or "overseas depository bank" has been defined to mean foreign depository as defined under the Scheme.
- The depository receipts can now be issued by way of public offering or private placement or in any other manner prevalent in the concerned jurisdiction and may be listed/traded in the concerned jurisdiction.
- The proceeds of the issue of depository receipts may also be remitted in an International Financial Services Centre Banking Unit and utilised in accordance with the instructions issued by the Reserve Bank of India.

Prosecutions against Independent Directors, non-promoters and non-KMP non-executive directors – Standard Operating Procedure: The Ministry of Corporate Affairs has by General Circular No. 5/2020 [F. No. 16/1/2020], dated 2nd March 2020, clarified the position of proceedings initiated against an officer of the company under several provisions of the Companies Act, 2013. The term "officer who is in default" is defined under Section 2(60) of the Act, wherein various officers of the company have been identified. The clarifications are as follows:

- Ordinarily the whole-time directors ("**WTD**") and key managerial personnel ("**KMP**") shall be liable for defaults committed by a company because of their association with day-to-day functioning of the company.
- In absence of a KMP, such director(s) who have expressly given their consent for incurring liability in terms of the e-form GNL-3, would be liable.
- In case the penal provisions in the Act hold a specific director/officer accountable for the default, then the action shall be initiated only against such director/officer.
- In view of express provision of Section 149(12), which provides that an independent director ("**ID**") or a non-executive director ("**NED**"), not being promoter or key managerial personnel would be liable only in respect of such acts or omission which had occurred with his knowledge, consent or connivance or where he has not acted diligently, it has been clarified that such directors shall not be arrayed in any criminal/civil proceedings under the Act, unless otherwise required under Section 149(12).

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- Instances of filing of information/records with the registry, maintenance of registers or minutes of the meeting etc., are not the responsibility of the ID or the NED. The responsibility of the NED shall only arise when there are no WTD/KMP.
- In case, lapses are attributable to the decisions taken by the Board, all care must be taken to ensure that no civil/criminal proceedings are initiated unnecessarily against the ID/NED, unless sufficient evidence exists to the contrary.
- To determine the serving director as on the date of default, the records available including e-forms DIR- 11 or DIR- 12 may be examined.
- In case of any doubts with regard to the liability of any person, guidance may be sought from the Ministry of Corporate Affairs.
- The abovesaid Standard Operating Procedure shall apply to all ongoing cases.

Filing of forms in MCA-21 Registry by Insolvency Professional appointed under IBC - Procedure: The Ministry of Corporate Affairs has by General Circular No. 04/2020 [F. No. 01/02/2019-CL-V], dated 17th February 2020 clarified the procedure to be followed by the Insolvency Professional when filing documents in the MCA-21 Registry in respect of a company, which is as follows:

- The Insolvency Professional shall file the NCLT order approving him/her as the Insolvency Professional in form INC-28 on the MCA-21 Portal by selecting the option "others" at Sl. No. 5(a)(i) in the form.
- The form shall be examined and approved by the jurisdictional ROC. Upon approval, the Insolvency Professional alone shall be allowed to file any form (SH-8, SH-9, iXBRL, MGT-7 etc.) on behalf of the company under the designation of "Chief Executive Officer".
- The Insolvency Professional as designated CEO shall again file e-form INC-28 upon the approval of the resolution plan/initiation of liquidation proceedings/withdrawal of application, based on which the status of the company will suitably be reflected in the company master data.
- In case a new board is required to be appointed, the details of the first authorised signatory of such board shall be inserted by the jurisdictional registrar after receiving an application from the Insolvency Professional.
- In case the order of admission of a company into CIRP/liquidation is stayed or set aside, such order shall be filed in Form INC-28 by the Insolvency Professional.

Guidelines for Portfolio Managers: The Securities and Exchange Board of India considering the deliberations of working group constituted to review the framework for regulation of Portfolio Managers under the SEBI (Portfolio Managers) Regulations, 2020 ("**PM Regulations**"), has made certain changes to the regulatory framework for PMs which will come into effect from 1st May 2020. The changes as brought in by SEBI/HO/IMD/DF1/CIR/P/2020/26, dated 13th February 2020 are as follows:

- **Fees and Charges:** No upfront fees shall be charged by the Portfolio Managers from the clients. The operating expenses excluding brokerage, over and above the fees charged for Portfolio Management Service, shall not exceed 0.50% per annum of the client's average daily assets under management. Charges for all transactions in a financial year shall be capped at 20% by value per associate per service.
- **Direct on-boarding of clients:** PMs shall provide an option to the client for direct on-boarding without intermediation of persons engaged in distribution services, without

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levying any extra charges apart from the statutory charges.

- **Investment Approach:** The information about investment approach offered by PMs shall be uniform across all types of regulatory reporting, client reporting, disclosure document, marketing material and any such document referring to services offered by the PMs.
- **Periodic Reporting:** The PMs shall report on an annual basis to SEBI on compliance with the provisions of the SEBI Circular on Improvement in Corporate Governance dated 18th November 2003. Further, PMs shall also submit a monthly report regarding their portfolio management activity on SEBI intermediaries Portal within 7 working days of the end of each month. The PMs shall also submit a certificate from a qualified Chartered Accountant certifying the net worth as on March 31 within 6 months from the end of financial year and a certificate of compliance with the PM Regulations signed by the Principal Officer within 60 days of end of each financial year. Further, the firm-level performance data of PMs shall be audited annually and reported to SEBI within 60 days of end of each financial year.
- **Supervision of Distributors:** The PMs shall utilize the services of only such distributors who have a valid AMFI Registration Number or have cleared NISM-Series-V-A exam and ensure that the clients are informed about the fees/commission earned by the distributors.

Operating Guidelines for Investment Advisors in International Financial Services Centre - Clarifications: The SEBI had issued Operating Guidelines for Investment Advisors in International Financial Services Centre *vide* circular dated 9th January 2020 ("**Circular**"). Based on the representation made by various stakeholders regarding Para 8(a) of the said Circular, the net worth requirement for registered Investment Advisor in IFSC is revised to USD 700,000. Further, in respect of Para 3 of the Circular, it is clarified that existing recognized entities in IFSC can also apply for Investment Advisors registration without forming a separate company or LLP. Circular No. SEBI/HO/IMD/DF1/CIR/P/2020/31, dated 28th February 2020 has been issued for the purpose.

SEBI (International Financial Services Centres) Guidelines, 2015 amended: The Securities and Exchange Board of India has amended the provisions of the SEBI (IFSC) Guidelines, 2015. The amendments as per SEBI/HO/MRD1/DSAP/CIR/P/2020/30, dated 27th February 2020 are as follows:

- **Clause 8(1):** Any SEBI-registered intermediary or its international associates may provide financial services relating to securities market in International Financial Services Centre ("**IFSC**") without forming a separate company, subject to the prior approval of SEBI. However, no SEBI prior permission is required in case financial services are offered exclusively to institutional investors. Further, in case the services are provided by non-SEBI registered intermediary, the prior approval of the SEBI is not required if such intermediary is recognized entity in a foreign jurisdiction.
- **Clause 19:** The entities issuing or listing debt securities in IFSC shall prepare their statement of accounts in accordance with IFRS/US GAAP/IND AS or accounting standards applicable in their place of incorporation.

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Margin Obligations to be given by way of Pledge/Re-pledge in Depository System: The Securities and Exchange Board of India has directed the Trading Members ("**TM**")/Clearing Members ("**CM**")/Depository Participants ("**DP**") with effect from 1st June 2020, to follow various measures to mitigate the risk of misappropriation or misuse of client's securities available with them. The obligations, as provided in SEBI/HO/MIRSD/DOP/CIR/P/2020/28 dated 25th February 2020 are as follows:

- The TM/CM shall accept collateral from clients in the form of securities only by way of "margin pledge" created in the Depository system as per the procedure laid down under the provisions of Depositories Act, 1996.
- The transfer of securities to the demat account of TM/CM shall be strictly prohibited. Even if the client has given a power of attorney ("**POA**") in favour of a TM/CM, such POA shall not be considered equivalent to the collection of margin by the TM/CM.
- The TM/CM shall open a separate demat account for accepting such margin pledge, which shall be tagged as 'Client Securities Margin Pledge Account'.
- For the purpose of providing collateral in form of securities as margin, a client shall pledge securities with TM, and TM shall re-pledge the same with CM, and CM in turn shall re-pledge the same to Clearing Corporation ("**CC**"). The re-pledge would mean endorsement of pledge by TM/CM in favour of CM/CC.
- Any dispute in regard to pledge, re-pledge, invocation or release shall be settled inter-se amongst client and TM/CM through arbitration as per the bye-laws of the depository.
- Funded stocks held by the TM/CM under the margin trading facility shall be held by the TM/CM only by way of pledge.
- The TM/CM shall be required to close all existing demat accounts tagged as 'Client Margin/ Collateral' by June 30, 2020. The TM/CM shall be required to transfer all client's securities lying in such accounts to the respective clients' demat accounts. Thereafter, TM/CM are prohibited from holding any client securities in any beneficial owner accounts of TM/CM.

Ratio Decidendi

Reverse corporate insolvency resolution process may be followed in the case of real estate companies to keep the company a going concern for completion of the project

Key points:

Corporate Insolvency Resolution Process ("**CIRP**"), without the approval of a third-party resolution plan, is permissible in case of real estate infrastructure companies, through the process of 'reverse CIRP', in the interest of the home buyers/allottees.

Brief facts:

The present company appeals were preferred by the association of allottees of Water Hills Project ("**Project**") developed by M/s. Umang Realtech Pvt. Ltd ("**Corporate Debtor**"), against the order admitting the application seeking CIRP against the Corporate Debtor, with specific prayers to not undergo CIRP through a third-party intervened resolution mechanism.

It is relevant to note that the allottees of the Project were the only financial creditors to the

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Corporate Debtor and there is no other third-party creditor. Owing to the nature of financial creditors, the CoC was not inclined to accept any third-party resolution plan and they wanted the flats to be allotted rightfully to all the allottees.

Therefore, (a) one of the promoters, Uppal Housing Pvt. Ltd ("**Promoter**") agreed to remain outside the CIRP and to play the role of a lender and Financial Creditor to ensure that the CIRP reaches successful completion and the allottees take possession of their flats/apartments during CIRP without any third-party intervention; and (b) a financial institution 'JM Financial Credit Solutions Limited' agreed to assist in the CIRP by providing funds for completion of Project.

Observations of the court:

Whether, during CIRP, the resolution process can reach finality without approval of a third-party proposed resolution plan?

Held: In the case of real estate infrastructure companies, the normal method of CIRP is difficult to implement and a reverse CIRP can be followed to safeguard the interest of the allottees and survival of the real estate companies to ensure the completion of the project.

In CIRP of a real estate company, the resolution should be confined to a particular project and cannot be extended to other projects of the same corporate debtor. Therefore, all the assets of the corporate debtor are not to be maximized and the maximization must be limited to a project, for balancing the unsecured, secured (financial institutions/banks) and operational creditors, as per the approved plan by the competent authority.

No other claims from allottees with respect to other projects can be made before the RP/ adjudicating authority.

The claims of the allottees participating in the CIRP are to be satisfied by providing the flat in the said project, ensuring the safety of the creditors of other projects or ventures of the Corporate Debtor. In such a CIRP, the secured creditors cannot be given preference by providing a flat/ apartment over the unsecured creditors who are the allottees of the project.

Allottees seeking refund of amounts is not allowed, in terms of the Supreme Court's judgment in *Pioneer Urban Land and Infrastructure Limited & Anr.* v. *Union of India & Ors.*, (2019) SCC OnLine SC 1005. However, the allottee may seek help of the resolution professional to arrange another purchaser for the allotted flat/ apartment.

This process of resolution has been termed as a 'Reverse Corporate Insolvency Resolution Process' to be followed in cases of real estate infrastructure companies in the interest of the allottees and survival of the real estate companies and to ensure completion of projects which provides employment to large number of unorganized workmen.

Judgment:

The appeal is disposed off with specific directions with regard to: (a) the Promoter is directed to collect monies from all allottees to be deposited in a separate account held in the name of the Corporate Debtor, to be utilized towards the running of the Project; (b) the CIRP to be completed after construction of all flats/ apartments, with amenities, and handover of the same to the allottees; (c) upon failure of the Promoter in completing the CIRP, the adjudicating authority shall complete the resolution process. [*Flat Buyers Association* v. *Umang Realtech Private Limited* - Company Appeal (AT) (Insolvency) No. 926 of 2019, Judgment dated 4th February, 2020, National Company Law Appellate Tribunal]

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Person having only security interest over assets of corporate debtor is not a 'financial creditor' as per definitions contained in sub-sections 5(7) and 5(8) of IBC

Key points:

A 'financial creditor' is a person who has direct engagement in the functioning of the corporate debtor. If a person having only security interest over the assets of the corporate debtor is also included as a financial creditor and thereby allowed to have its say in CIRP, the growth and revival of the corporate debtor may be the casualty.

Brief facts:

Jaypee Infratech Limited ("**Corporate Debtor**") had mortgaged its properties as collateral securities for the loans and advances made by the lender banks and financial institutions to Jaiprakash Associates Limited ("**JAL**"), the holding company of Corporate Debtor.

The interim resolution professional sought to avoid transactions between Corporate Debtor and JAL by which mortgages were created on assets of Corporate Debtor for loans taken by JAL as being preferential, undervalued and fraudulent. Interim resolution professional further rejected the claims of lenders of JAL to be recognized as financial creditors of the corporate debtor JIL on the strength of the mortgage created by the corporate debtor

After undergoing several rounds of proceedings before NCLT and NCLAT, the issued ended up before Supreme Court.

Observations of the court:

Whether the transactions of mortgaging properties for loans and advances taken by holding company were preferential, undervalued and fraudulent and sought to be avoided?

Held: The Court held that the transfers in question could be considered outside the purview of sub-section (2) of Section 43 of the Code only if it could be shown that same were made in the 'ordinary course of business or financial affairs' of the corporate debtor JIL and the transferees. And the expression "or", appearing as disjunctive between the expressions "corporate debtor" and "transferee" in sub-section (3) of section 43 ought to be read as "and". The Court held that the Corporate Debtor inflated itself to the extent of routinely mortgaging its assets and/or inventories to secure the debts of its holding company and it is not the ordinary course of financial affairs of Corporate Debtor that it would create encumbrances over its properties to secure the debts of its holding company. Therefore, it was held that the transactions are hit by Section 43 of the Code.

Whether lenders of JAL could be considered as financial creditors of the Corporate Debtor?

Held: The basic elements of 'financial debt' are that it ought to be a disbursal against the consideration for time value of money which is an essential part even in respect of any of the transactions/dealings stated in sub-clauses (a) to (i) of Section 5(8). Relying on *Swiss Ribbons Private Limited and Anr. v. Union of India and Ors.* [(2019) 4 SCC 17], the Court held that 'financial creditor' is a person who has direct engagement in the functioning of the corporate debtor and who is involved right from the beginning while assessing the viability of the corporate debtor. If a person having only security interest over the assets of the corporate debtor is also included as a financial creditor and thereby

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allowed to have its say in CIRP, the growth and revival of the corporate debtor may be the casualty. The Court finally held that lenders of JAL could not be treated as financial creditors, although they may fall in the category of secured creditors, but such mortgages being neither towards any loan, facility or advance to the corporate debtor nor towards protecting any facility or security of the corporate debtor.

Judgment:

The appeals are allowed, and the directions by NCLT for avoidance of such transactions and rejection of recognizing the lenders of JAL as financial creditors of Corporate Debtor are restored accordingly. [*Anuj Jain, IRP for Jaypee Infratech Limited* v. *Axis Bank Ltd and Ors.* - Civil Appeal Nos. 8512-8527 OF 2019, Judgment dated 26th February, 2020, Supreme Court of India, Three-Judge Bench]

When disputed questions of facts are involved to be adjudicated after the parties adduce evidence, the complaint u/s. 138 of NI Act ought not to be quashed.

Key Points:

Inherent Powers under Section 482 of Code of Criminal Procedure, 1973 ("**CrPC**"), with respect to quashing of proceedings under Section 138 of Negotiable Instruments Act, 1881 ("**NI Act**") does not extend to quashing on account of disputed questions of facts.

Facts:

The criminal appeals were preferred against the impugned judgments of the High Court of Gujarat, declining to quash an FIR registered against the Appellants herein for forgery as well as acquitting the Respondents for dishonor of cheques under Section 138 of the Negotiable Instrument Act by quashing of proceedings under inherent powers under Section 482 of CrPC.

The facts of the case enclose the purchase of property inherited by Appellant No. 1 and Respondent No. 1, by Appellant No. 3. Towards the purchase, certain amounts were transferred by Appellant No. 3 to Respondent No. 2, for which receipts were obtained. However, the sale never fructified, and the Respondent No. 1 issued cheques to Appellant No. 3 for refund of amounts. The cheques were however dishonored.

Alleging that the Appellants have forged and fabricated the Receipts, Respondent No.2 has filed the complaint for cheating and forgery against the Appellants. The Appellant No. 3 filed a case of dishonor of cheque.

Observations by the Court:

Whether the proceedings under Section 138 of the NI Act can be quashed on account of disputed questions of fact?

Held: No. Respondent No. 1 had admitted to the issuance of cheques and hence, the presumption in favour of the complainant would arise under Section 139 of the NI Act. Until the accused rebuts the presumption by adducing evidence, the presumption still lies. When disputed questions of facts are involved which need to be adjudicated after the parties adduce evidence, the complaint under Section 138 of NI Act ought not to be quashed relying on the inherent powers of the High Court under Section 482 of CrPC.

Judgment:

The appeals are allowed and criminal proceedings under Section 138 of NI Act stand restored. [*Rajeshbhai Muljibhai Patel & Ors.* v. *State of Gujarat & Anr.* - Criminal Appeal Nos. 251-252 of 2020, Judgment dated 10th February, 2020, Supreme Court of India]

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News Nuggets

Companies (Incorporation) Amendment Rules, 2020

The Ministry of Corporate Affairs has amended the Companies (Incorporation) Rules, 2014 with effect from 23rd February 2020. As per the amended Rule 9, an application for reservation of name shall be made through the web service SPICe+ (Simplified Proforma for Incorporating Company Electronically Plus: INC -32). Further, the application for incorporation of a company under Rule 38 of the Principal Rules shall be accompanied by e-form AGILE-PRO (Application for Goods and Services tax identification number, Employees' State Insurance Corporation plus Employees Provident Fund Organization registration, Profession tax Registration and Opening of bank account), for registration of GSTIN, EPFO, ESIC, Profession Tax Registration and opening of bank account. Notification No. G.S.R. 128(E) dated 18th February 2020 has been issued for the purpose.

Virtual currencies – RBI Circular restricting functioning of VC exchanges set aside

The Larger Bench of the Supreme Court of India has set aside the Circular dated 6-4-2016 issued by the Reserve Bank of India, directing the entities regulated by RBI to not to deal with or provide services to any individual or business entities dealing with or settling virtual currencies and to exit the relationship, if they already have one, with such individuals/ business entities dealing with or settling virtual currencies. The RBI Circular was held as not correct on the grounds of 'proportionality' as in Article 19 of the Constitution of India. The Apex Court in its judgement dated 4th of March, 2020 in the case of *Internet and Mobile Association of India v. Reserve Bank of India* noted that though virtual currencies were not banned, but the trading in VCs and the functioning of VC exchanges were sent to comatose by the impugned Circular by disconnecting their lifeline namely, the interface with the regular banking sector.

Consumer Protection Act – Time limit for responding to complaint is mandatory

In a dispute pertaining to the provisions of the Consumer Protection Act, 1986 the 5-Judges Constitutional Bench of the Supreme Court has held that the District Forum has no power to extend the time for filing the response to the complaint beyond the period of 15 days in addition to 30 days as is envisaged under Section 13 of the Consumer Protection Act. The provisions of Section 13(2) were thus held mandatory and not directory. Further, in respect of point of commencement of limitation of 30 days, the Apex Court in its decision dated 4th of March 2020 the case *New India Assurance Co. Ltd. v. Hilli Multipurpose Cold Storage Pvt. Ltd.* was of the view that the commencing point of limitation of 30 days under Section 13 would be from the date of receipt of the notice accompanied with the complaint by the opposite party, and not mere receipt of the notice of the complaint.

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Change of auditor – Companies Act Section 140(5) not invokable for negligent acts of auditor

Setting aside the order of NCLT, Mumbai Bench, NCLAT has held that an auditor cannot be debarred under Section 140(5) of Companies Act, 2013 in absence of fraudulent acts although the auditor has acted negligently.The Appellate Tribunal in the case *Mukesh Maneklal Choksi v. Union of India* observed that though the act of the appellant was certainly a negligent act but there was no material on record to infer that he had acted fraudulently and colluded with the directors of the company in relation to affairs of the company or he had misused his position as statutory auditor of the company.

Criminal investigations against the 'Corporate Debtor' stands abated upon approval of Resolution Plan

NCLAT, in its Order dated 17th February 2020 has held that a plain reading of Section 32A(1) and (2) of IBC clearly suggests that the Directorate of Enforcement/other investigating agencies do not have the powers to attach assets of a 'Corporate Debtor', once the 'Resolution Plan' stands approved and the criminal investigations against the 'Corporate Debtor' stands abated. The Appellate Tribunal was of the view that Section 32A of the IBC does not in any manner suggest that the benefit provided thereunder is only for such resolution plans which are yet to be approved. Further, the NCLAT in the case *JSW Steel Ltd. v. Mahender Kumar Khandelwal* held there is no basis to make distinction between a resolution applicant whose plan has been approved post or prior to the promulgation of the IBC (Amendment) Ordinance, 2019.

Draft Competition (Amendment) Bill, 2020 – Comments invited

The Ministry of Corporate Affairs had constituted a Competition Law Review Committee (CLRC) to review and recommend a robust competition regime in India. Based on the review and analysis of the competition framework, the CLRC submitted its report to the Government and accordingly a draft Competition (Amendment) Bill, 2020 has been published for inviting public comments. According to the proposals, the definition of 'cartel' will include 'buyer cartels' as well. Further, while protection to holders of IPR will be extended to abuse of dominant position also, definition of 'control' and 'group' are also set to be revised in respect of combinations.

Nidhi Rules, 2014 amended

The Ministry of Corporate Affairs has amended the Nidhi Rules, 2014 with effect from 15th February 2020, wherein the time period for seeking declaration in accordance with Rule 3A of the Rules, has been extended from 3 months to 9 months from the date of commencement of Nidhi (Amendment) Rules, 2019 or within a period of 1 year from the date of its incorporation, whichever is later. In addition to the above, a second notification dated 2nd March 2020 was issued to make similar timeline changes in first proviso to Rule 23B. As a result of which, no fees shall be charged for filing form NDH-4 in case it is filed within 9 months of the commencement of the Nidhi (Amendment) rules, 2019. Notification No. G.S.R. 114(E) dated 14th February 2020 and Notification No. G.S.R. 150(E) dated 2nd March 2020 have been issued for the purpose.

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