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Contents

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Articles

Luck Factor – An analysis of changes in Gaming Law

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Introduction

In today's world, there is no sector or industry which does not marginally, if not entirely, depend on technology for its business purposes. This has shrunk the physical world and enlarged the virtual space, increasingly so in the field of gaming, thereby changing its rules. Now, almost all games can be played online.

We may note that some states like Assam and Orissa have made games played with stakes illegal. In a similar fashion, the recent Ordinances issued by the Government of Telangana, (4 and 6 of 2017)[1] (Ordinances), amending certain provisions of the Telangana State Gaming Act, 1974, have dealt a bad hand to the players and organisers of Online Rummy, resulting in their casting away their cards abruptly.

The Ordinances have explained that 'rummy' is partly a game of skill and partly a game of luck/chance. To clarify further, the Ordinances conclusively state that a game that depends partly on skill and partly on chance, cannot be termed as a skill game. Further, the Ordinances also defines the term 'wagering' in an elaborate manner, to mean, collecting or soliciting bets; receiving or distributing winnings for any wager or bet; an act intended to aid, induce, solicit or facilitate wagering or betting, or an act of risking money or otherwise, on the happening of an uncertain event with an unknown result (including a skill game); any action carried out directly or indirectly by players playing any game, or by third parties.

In order to understand the inherent issues embedded in online rummy, we may briefly discuss the evolution of law in this regard, which began as early as 1867, with the introduction of the Public Gambling Act.

Public Gambling Act, 1867

The first law relating to gambling and betting in India was the Public Gambling Act, 1867. It is essential to note that 'Gambling and Betting' fall under Entry 34 of List II of the Seventh Schedule of the Constitution of India, i.e. under the State List. Accordingly, States are empowered to legislate on such activities, with the exclusion of lotteries[2].

The scheme that was adopted by the Public Gambling Act, 1867, has been extended to other States by either extending the provisions of this Act or by enacting new statutes with similar provisions. The Public Gambling Act, 1867 and most of the State legislations have, however, expressly excluded 'games of skill' from the application of the different gaming statutes, except Assam and Orissa. However, the term 'game of skill' has not been defined in the said Act. Sikkim has brought about Sikkim Online Gaming (Regulation) Act, 2008, for regulating and restricting online gaming, which includes all or any games of chance or games which are a combination of skill and chance. There are certain important terms that have been defined in the said Act such as 'common gaming-house' which includes all the places where games are

[1] Ordinance No. 4 of 2017, issued on 17th June, 2017 and Ordinance No. 6 of 2017, issued on 8th July, 2017.

[2] The Constitution of India, Entry 40, List I of the Seventh Schedule: *'Lotteries organised by the Government of India or the Government of a State'*

played, 'instruments of gaming' through which games are played.

Constitution of India

The term 'gambling' has not been defined in any of the Acts. According to Black's Law Dictionary "*gambling involves, not only chance, but a hope of gaining something beyond the amount played. Gambling consists of consideration, an element of chance and a reward*." Further, the Supreme Court in *State of Bombay* v. *R.M.D. Chamarbaugwala*[3],and *Dr. K.R. Lakshmanan* v. *State of Tamil Nadu & Another*[4], has interpreted the term 'gambling' to not include events where a 'substantial degree of skill' is involved.

It is however to be noted that for a limited tax purpose, Section 65B (15) of the Finance Act, 1994 defines the term 'betting or gambling' as follows:

> *"betting or gambling" means putting on stake something of value, particularly money, with consciousness of risk and hope of gain on the outcome of a game or a contest, whose result may be determined by chance or accident, or on the likelihood of anything occurring or not occurring.*

The Hon'ble Delhi District Court in *Gaussian Network Private Limited* v. *Monica Lakhanpal and Ors.*[5] had opined that games played online, with stakes, are illegal in States which prohibit gambling, and enterprises which organise/conduct such games do not enjoy the protection of freedom to practice any trade under Article 19(1)(g) of the Constitution of India, since gambling would be an illegal trade in that State. However, the revision petition filed before the Hon'ble Delhi High Court against the afore-mentioned case has been withdrawn. Article 19(1)(g) of the Constitution of India does allow every individual to practice any trade as he pleases, as long as it is not illegal. However, if a legislation prohibits playing of certain games which fall within the ambit of gambling, then anyone who practises trade using such games, would essentially be conducting an illegal activity, thereby losing the umbrella of protection offered under Article 19(1) (g).

Other legislations applicable to the Gaming Industry

Intermediaries i.e. telecom/network/internet/ web-hosting service providers, search engines, online payment/auction sites, online market places and cyber cafes, have the obligation to inform users of computer resources not to host, display, upload, modify, publish, transmit, update or share any information that encourages gambling[6]. User agreements and other policies floated by the intermediaries are required to contain terms which prohibit the above.

A person carrying on activities for playing games of chance for cash or kind, and includes such activities associated with casino, shall fall under the purview of a 'person carrying on designated business or profession' under the Prevention of Money Laundering Act, 2002 (PMLA)[7] and shall be required to comply with the reporting requirements of PMLA, like maintaining records of all transactions, furnishing the same to the Director of Financial Intelligence Unit, verifying identities of clients etc.

The Foreign Direct Investment (FDI) Policy, 2016, prohibits FDI activity in some sectors, which *inter alia,* include (i) Lottery business

[3] AIR 1957 SC 699
[4] (1996) 2 SCC 226
[5] Suit no. 32/12, judgment dated 17th September, 2012.

[6] Rule 3 (2) (b) of the Information Technology (Intermediaries Guidelines) Rules, 2011, r/w Section 2(1) (w) of the Information Technology Act, 2000.
[7] Section 2 (1) (sa) of Prevention of Money Laundering Act, 2002.

including government/private lottery, online lotteries; and (ii) Gambling and betting including casinos etc. Even collaboration of foreign technology in any form like licensing for franchise, trademark, brand name, management contract, is prohibited for lottery business and gambling and betting activities[8].

Further, even remittance of foreign exchange by any person for (i) lottery winnings; (ii) income from racing/riding, etc., or any other hobby; and (iii) for purchase of lottery tickets, banned/prescribed magazines, football pools, sweepstakes etc.[9] is prohibited.

What is rummy?

Rummy is a popular 13 card game played with sets of playing cards. Rummy in India is usually played among 2 to 6 players where each player has to, in turn, draw and discard one card until the 13 cards form a sequence in sets. The basic objective in every rummy game is to improve the player's hand by dealing sets of cards and forming a particular sequence adhering to certain rules of the game, which require a certain set of skills in memorizing the fall of cards and building up the game in holding and discarding the cards. Similar rules are followed when the game is played online.

Skill Game v. Luck Game

Since the term 'game of skill' has not been defined, except in the Ordinances, it becomes important to understand the meaning of this term and apply the ratio to 'online rummy'. If any game is purely a skill game, then it will not fall foul of the Ordinances. Contrarily, chance/luck games are penalised for being played.

Rummy, predominantly a skill game

The issue as to whether rummy, as described hereinabove, is a game of 'chance' or 'skill' was considered by the Hon'ble Supreme Court in *State of Andhra Pradesh* v. *K. Sathyanarayana*[10]*,* wherein, while allowing rummy to be played in clubs, it was observed that it is mainly and preponderantly a game of skill.

The Hon'ble Supreme Court in *Dr. K.R. Lakshmanan* v. *State of Tamil Nadu & Another (Supra)* observed that rummy is a game of skill, like golf and chess, since an element of chance, although present, is not the fulcrum on which the game rests, but superior knowledge, experience and finesse of a player are the deciding factors, which roughly translate to 'skill.'

The division bench of the Hon'ble Andhra Pradesh High Court in *D. Krishna Kumar & Anr* v. *State of Andhra Pradesh*[11]*,* discussed the provisions of the Andhra Pradesh Gaming Act, 1974, and had held that since rummy (which is a game of skill) played with stakes does not fall under the definition of 'gaming' under the said Act, till such time the legislature amends the said Act, it would be considered legal.

Position if played with/ without stakes

The Hon'ble Madras High Court in *The Director General of Police* v. *Mahalakshmi Cultural Association*[12]***,*** had opined that playing rummy without stakes is legal and if the same is played with stakes, it would amount to gambling. However, on an appeal against the above-mentioned decision of the Hon'ble Madras High Court, the Hon'ble Supreme Court has stayed the operative portion of the decisions and has observed that the decision of Madras High Court has nothing to do with online rummy.

[8] Clause 5.1 of Foreign Direct Investment Policy, 2016

[9] Schedule I (*Transactions which are prohibited*) of Foreign Exchange Management (Current Account Transactions) Rules, 2000

[10] AIR 1968 SC 825

[11] 2002 (5) ALT 806

[12] W.A.No.2287 of 2011

Is there any game with no element of 'chance/luck?'

The Hon'ble Supreme Court has, in the case of *M.J. Sivani and Ors.* v. *State of Karnataka and Ors.*[13] held that:

> *"No game can be a game of skill alone. In any game in which even great skill is required, chance must play a certain part. Even a skilled player in a game of mere skill may be lucky or unlucky, so that even in a game of mere skill, chance must play its part. But it is not necessary to decide in terms of mathematical precision the relative proportion of chance or skill when deciding whether a game is a game of mere skill. When in a game the element of chance strongly preponderates, it cannot be a game of mere skill."*

Reasonable Classification

From the above decisions, it can be noted that 'rummy' is predominantly considered as a substantial game of skill. The decision in *M.J. Sivani* (cited supra) clarifies that the element of chance/luck is inherent in every game, be it a skill game or a game of chance. It is difficult to not decipher some element of chance in all games. Be it the game of cricket, football, or chess, all of which begin with a 'toss', which, more often than not, may put one player/team, at an advantageous position. Furthermore, even trading in securities over stock exchanges involves immense speculation, resulting in the existence of an element of chance. The stipulation in the Ordinances that a 'skill game' is a game which is *totally* based on skill and the ability of the player, is counter-intuitive. In light of this, the question which may arise is whether classification of a game as a partly skill game and a partly chance game as a 'non-skill' game is appropriate or not.

Other Jurisdictions

Countries with which India has trading relations, like USA, UK, France, Italy and Ireland have legalised online gaming played with stakes, by virtue of central or state legislations, thereby attracting positive investment. Countries like Singapore, UAE, North Korea, among others, have made online gaming, played with stakes, illegal. However, predominantly, online gaming played with stakes is a permitted legal activity across the world.

Conclusion

The decisions of various Courts essentially stipulate that rummy is not a game of chance and is a substantial game of skill. Therefore, it will not be altogether wrong in stating that the view of the legislature which has passed the Ordinances, making even rummy (online or not) illegal, is not in line with the view of the judiciary, leading to the rise of dawning confusion.

Many entrepreneurs have, in Telangana, invested in infrastructure related to hosting online games, but their hands will now be tied, since the Ordinances have, in no unclear terms, stated that rummy (whether played online, or offline, with or without stakes), not being a game of skill, is illegal. The basis of attempting to make such a law is indistinct, but as stated earlier by the Hon'ble Apex Court, there is no game which does not have even an iota of chance in it. Therefore, the Ordinances have, in a way, negated the view of the judiciary, by trying to establish that rummy is not a skill game.

However, writ petitions have been filed before the Hon'ble High Court at Hyderabad, challenging the validity of the Ordinances, as being *ultra vires* Articles 14, 19(1) (g) and 21 of

[13] (1996) 2 SCC 226

the Constitution of India, which are pending adjudication. Upon their adjudication, we may understand whether the judiciary elects to follow its own precedents or would resort to not interfering in the legislative process.

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Notifications

Insolvency and Bankruptcy Code (Amendment) Ordinance, 2017: The President of India, on 23rd November, 2017[1], promulgated the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2017, which amends the existing Insolvency and Bankruptcy Code, 2016 (IBC), in order to strengthen the insolvency resolution process. A brief summary of some key amendments as per the Ordinance, is as follows:

1. *Duties of Resolution Professional:* The insolvency professional, when inviting prospective resolution applicants to submit a resolution plan, is required to ensure that such applicant fulfills the requisite criteria as laid down by the Committee of Creditors, regarding the complexity and scale of operations of the business of the corporate debtor.
2. *Persons not eligible to be resolution applicants* – To curb the possibility of defaulting promoters of ailing entities from submitting resolution plans that may in turn lead to them acquiring the concerned entity's assets at low valuations, henceforth any person, whether acting alone or jointly with any person, who is a promoter or in the management or control of such person will not be eligible to submit a resolution plan in case:

(a) It is an undischarged insolvent;
(b) It has been identified as a willful defaulter as per the Banking Regulation Act, 1949;
(c) Its accounts have been classified as non-performing assets for more than a year and he has failed to make overdue payments relating to such non-performing assets;
(d) It has been convicted for any offence punishable with imprisonment for two years or more;
(e) It has been disqualified to act as a Director under Companies Act, 2013;
(f) It has been prohibited by SEBI for trading securities;
(g) It has indulged in preferential, undervalued or fraudulent transactions wherein an order has already been passed;
(h) It is a guarantor in favour of a creditor under the Corporate Insolvency Resolution Process or liquidation processes under IBC;
(i) It is a 'connected person' who meets any of the abovementioned criteria.
A connected person has been defined to mean any person who:
(i) is a promoter or in the management or control of the resolution applicant;

[1] Notification No. DL- (N)04/0007/2003-17

(ii) who shall be a promoter or control of the business of the corporate debtor during the implementation of the plan;

(iii) The holding company, subsidiary company or related party of a person referred above.

(j) It is subject to any disability under any foreign laws.

3. *Submission of resolution plan:* When considering the approval of a resolution plan, the Ordinance mandates the Committee of Creditors to consider the feasibility and viability of the plan.
   Further, a resolution plan submitted before the commencement of the present Ordinance by a resolution applicant who is otherwise ineligible under the IBC, shall not be approved by the Committee of Creditors, therefore requiring invitation of fresh resolution plans from eligible resolution applicants.
4. *Powers and duties of liquidator:* Henceforth, a liquidator is not to sell immovable land and movable property or actionable claims of the Corporate Debtor to persons otherwise not eligible to be resolution applicants. This amendment too is aimed at preventing defaulting promoters from acquiring distressed assets at low valuations.
5. *Punishment where no specific penalty or punishment is provided:* Where any person contravenes any provision of IBC for which no punishment has otherwise been prescribed under IBC, such person shall be punishable with fine that may range between INR 1 Lakh and INR 2 Crores.

Insolvency and Bankruptcy – Committee of Creditors to carry out due diligence of resolution plan: Insolvency and Bankruptcy Board of India *vide* two recent notifications dated November 7, 2017, has introduced certain amendments to the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 and Insolvency and Bankruptcy Board of India (Fast Track Insolvency Resolution Process for Corporate Persons) Regulations, 2017. The amendments empower the Committee of Creditors to carry out due diligence of a resolution plan and satisfy itself that persons who have submitted such plan are credible and the resolution plan is viable. Parallel amendments have also been made to the regulations governing the fast-track insolvency resolution process for corporate entities.

Henceforth, a resolution plan is required to contain certain crucial details of the resolution applicant and other connected persons, so as to enable the committee to access their credibility and take a prudent decision while considering the resolution plan for approval. Details required include the identity of the resolution applicant, whether such applicant has been convicted for any offence in the preceding five years, has any pending criminal proceedings, has been disqualified to act as a director under Companies Act, 2013, has been identified as a wilful defaulter, or has been debarred by Securities and Exchange Board of India from accessing or trading in securities market and whether any transactions have been made with the corporate debtor in the past two years.

Further, the resolution professional shall be required to submit to the Committee of creditors, resolution plans which include details of preferential transactions, undervalued transactions, extortionate credit transactions, fraudulent transactions, and the orders, if any, of the adjudicating authority in respect of such transactions, if any found by the resolution professional.

Directions on Managing Risks and Code of Conduct in Outsourcing of Financial Services by NBFCs: The Reserve Bank of India ("RBI") has on 9-11-2017 issued directions to Non-Banking Financial Companies ("NBFCs"), requiring NBFCs to put in place necessary safeguards on outsourcing of activities by them. Generally, activities like applications processing (loan origination, credit card), document processing, marketing and research, supervision of loans, data processing and back office related activities etc., are outsourced by NBFCs to third-party service providers, which exposes NBFCs to various risks. These directions are applicable to material outsourcing arrangements entered into by an NBFC with a service provider located in India or abroad.

With a view to protect the interests of customers of NBFCs and to ensure that NBFCs follow sound and responsive risk management practices for effective oversight, due diligence and management of risks arising from such outsourced activities, the latest directions prohibit NBFCs from outsourcing core management functions including Internal Audit, Strategic and Compliance functions and decision-making functions, with certain specified exceptions. Some additional key provisions are as follows:

- NBFCs are required to put in place a comprehensive outsourcing policy which must be approved by its board. NBFCs will have the ultimate responsibility for the outsourced activity and they will be responsible for all the actions of the service provider. Outsourcing arrangements will not affect the customers' rights against the NBFC which includes their right to grievance redressal.
- NBFCs often have back-office arrangements with group entities for sharing of premises, professional services, centralized back-office functions, etc. Before NBFCs enter into any such arrangements with group entities, the Directions require NBFCs to have a Board-approved policy and appropriate service level agreements/ arrangements on the sharing of resources with their group entities, in place.
- If an NBFC is entering in outsourcing arrangements with off-shore service providers, it shall do so only with the entities operating in jurisdictions which uphold confidentiality clauses and agreements.
- NBFCs are required to carry out appropriate due diligence to assess the capability of the service provider before considering or renewing an outsourcing agreement. A management structure to monitor and control the outsourcing activities shall be put in place by NBFC.
- NBFC would be responsible for making currency transaction reports and suspicious transaction reports for the customer related activities carried out by the service provider.
- To ensure strict confidentiality measures, the NBFC shall provide customer information to the staff of service providers on 'need to know' basis i.e. limited to those areas where information is required in order to perform the outsourced functions. NBFC shall regularly review and monitor the security practices and control processes of the service provider. Further, RBI shall immediately notify RBI in the event of breach of security and leakage of confidential customer-related information and on occurrence of such an event, NBFC will be liable to its customers for any damages.

- A code of conduct for the direct sales agents/ direct marketing agents/recovery agents shall be put into place.
- NBFCs shall establish a viable contingency plan and in order to mitigate the risk of unexpected termination of the outsourcing agreement or liquidation of the service provider.
- NBFCs shall constitute a grievance redressal mechanism for redressing issues relating to the outsourced activities.

Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017 issued: The Reserve Bank of India ("RBI") on November 7, 2017 issued the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017 ("New TISPRO Regulations") superseding the existing FEMA 20/2000-RB [FEM (Transfer or issue of security by a Person Resident outside India) Regulations, 2000] and FEMA 24/2000-RB [FEM (Investment in Firm or Proprietary Concern in India) Regulations, 2000] regulations.

Whereas most provisions of the New TISPRO Regulations have come into effect, certain provisions regarding the procedure to be followed in the event of breach of Investment and/or sectoral limits by Foreign Portfolio Investors (FPI), Non-resident Investors (NRI) or Overseas Citizens of India (OCI) as the case maybe, are yet to be notified.

Some significant changes that have been introduced by the New TISPRO Regulations are outlined below:

- *Capital Instruments* - The New TISPRO Regulations provides for an exhaustive definition of "*capital instruments*" which includes equity shares, compulsorily and mandatorily convertible preference shares, compulsorily and mandatorily convertible debentures, share warrants as well as partly paid shares. Earlier, reference was made to the definition of "*warrants*" provided under the Companies Act, 1956, however with the exclusion of the definition of "*warrants*" under Companies Act, 2013, the New TISPRO Regulations expressly refers to the relevant regulations issued by Securities Exchange Board of India (SEBI). The common conditions for public and rights issue under SEBI (Issue of Capital and Disclosure Requirements), 2009 stipulates a tenure of 18 (eighteen) months for share warrants and the realization of least 25% (twenty-five) of the consideration amount upfront, which has been appropriately incorporated in the definition of capital instruments.
- *Foreign Direct Investment* **–** The term "*investment*" has been broadly used throughout these regulations and has accordingly been defined to include all modes of investment by a person resident outside India including subscription, acquisition, holding or transfer of any security or unit issued by a resident. As FEMA 20/2000 and FEMA 24/2000 have been merged, the term "*investment*" includes capital contribution and acquisition/transfer of profit shares in a Limited Liability Partnership. Further, the New TISPRO Regulations seeks to align the definition of "*Foreign Direct Investment*" with the definition of Foreign Portfolio Investment and thereby a distinction is also created between listed and unlisted companies. Any foreign investment made in an unlisted Indian company will be treated as Foreign Direct Investment (FDI). In case of listed companies, investment to the tune of 10 per cent or more of the post issue paid-up equity capital made on a fully diluted basis, would be considered as FDI.
- *Foreign Portfolio Investment* - Some of the changes brought about in the New TISPRO

Regulations is a conscious move to shift from the Foreign Institutional Investor (FII) regime to the FPI regime. The idea is to simplify the classification of foreign investors and merge categories of FII and Qualified Financial Investor (QFI) to be identified as a single category. The definition of FPI is in line with the provisions of the SEBI (FPI) Regulations, 2014, which specifically states that the aforesaid limit of 10% shall be applicable to each FPI investor or investor group. As per the New TISPRO Regulations, the aggregate limit of all FPIs put together should not exceed 24 (twenty-four) percent of paid-up equity capital, which limit may be increased up to the statutory cap/ceiling with requisite board and shareholder approvals.

- *Downstream investment* – Although the provisions with regards to calculation of total foreign investment as well as conditions in relation to downstream investment remain same, certain elements have been added such as downstream investment made by a banking company under a debt/loan restructuring mechanism by way of acquisition of shares shall not count towards indirect foreign investment. Further the downstream investment should have approval of the Board and be evidenced by a Shareholder's agreement, if any.
- *Period of issuance of capital instruments* **–** As per Section 42 of the Companies Act, 2013, allotment of securities by private placement are to be made within 60 days of the receipt of application money. The New TISPRO Regulations has aligned the mandated issuance period from 180 days to 60 days calculated from the receipt of inward remittance, in line with Companies Act, 2013.
- *Convertible notes issued by startup companies* - The New TISPRO Regulations prescribes reporting requirements for the issue or transfer of convertible notes by an Indian startup company to a person resident outside India, where such startup company shall be required to file Form CN with the Authorized Dealer Bank (AD Bank) within 30 (thirty) days of such issue or transfer.
- *FC-TRS reporting* **–** Previously the onus of reporting transfer of shares of an Indian company by a person resident in India to a person resident outside India or *vice-versa*, was on the resident transferor/transferee resident in India. Under the New TISPRO Regulations, the onus of reporting such transfer of shares (in Form FC-TRS) is on the resident transferor/transferee OR on the person resident outside India holding capital instruments on a non-repatriable basis, as the case may be. In case of transfer of capital instruments on a deferred basis, the sole responsibility of reporting is of the resident transferor/transferee.
- *Late reporting* **–** The New TISPRO Regulations provides a relaxation for delayed reporting of FDI with payment of late submission fees, as decided by RBI in consultation with the Central Government. Under the previous regime, such late filing was an offence wherein an application was required to be made to the concerned regional offices of RBI for compounding such contraventions as per the procedure prescribed.

Securities and Exchange Board of India (International Financial Services Centres) Guidelines, 2015 – Amendments: In its Circular dated November 14, 2017 ("Circular"), SEBI has amended the guidelines for International Financial Services Centres ("IFSC") wherein SEBI has introduced an amended definition of an 'Issuer' in the SEBI (IFSC) Guidelines, 2015 ("Guidelines").

Previously, the definition of 'Issuer' referred to *inter-alia* "*…a company incorporated in a foreign jurisdiction*". Hence, a company incorporated in a foreign jurisdiction could raise capital in India, irrespective of the domestic laws of its country of incorporation/establishment/place of business.

However, the new definition clarifies that only those foreign companies whose domestic laws of its country of incorporation/establishment/place of business allow them to issue securities to investors outside that country, would be considered as an 'Issuer' under the Guidelines. As a result, the Circular has excluded foreign companies who are not allowed to issue securities outside the country according to their domestic laws from being an Issuer, thereby protecting the interests of investors.

The latest amendment also expands the definition of an 'Issuer' by specifying that any supranational, multilateral or statutory organization or institution or agency (who are permitted to issue securities as per their constitution), can also be an issuer.

Investment by FPIs in Government Securities – SEBI revises limit: SEBI has recently revised the limit for investments by Foreign Portfolio Investors (FPI) in Government Securities. The revised investment limits for October-December 2017 quarter, in comparison to the investment limits previously in place for July – September 2017 quarter, according to SEBI Circular No. IMD/FPIC/CIR/P/2017/113, dated 4-10-2017 are,

Type of Instrument	Upper Cap as on July 04, 2017 (INR cr)	Revised Upper Cap with effect from October 03, 2017 (INR cr)
Government Debt –General	187,700	189,700
Government Debt–Long Term	54,300	60,300
SDL –General	28,500	30,000
SDL –Long Term	4,600	9,300
Total	275,100	289,300

All other conditions with regard to allocation and monitoring of debt limits shall continue to apply.

Ratio Decidendi

Applicability of Limitation Act to IBC - Limitation period applicable from the time right to apply accrues

Brief overview:

The National Company Law Appellate Tribunal (NCLAT) held that the adjudicating authority incorrectly dismissed an application for initiation of corporate insolvency resolution under the Insolvency and Bankruptcy Code, 2016 (IBC) process by terming it as a time-barred debt.

Facts:

The Appellant entered into a Business Conducting Agreement (Agreement), dated February 1, 2008 with the Respondent to conduct and manage the business of running a music concept store, wherein the Respondent was liable to pay a monthly fee of Rs.11 lakhs to the Appellant. An addendum to the Agreement was entered into between the Parties in June 2009 whereby the monthly fee was reduced to Rs. 7 Lakhs for a period of 26 months until March 2011. The Appellant contended that the Respondent continued to pay the reduced fee for a period commencing from March 2011 to September 2011. However, the Respondent failed to pay the abovementioned fee post

October 2011. The Appellant, therefore, terminated the Agreement and further issued a notice under Section 8 (1) of the IBC for repayment of Rs. 3,92,38,405. The Respondents however denied payment on the ground that the Appellant failed to duly perform its duty as per the terms of the Agreement. Ten days post the receipt of such response, the Appellant filed an application to the Adjudicating Authority (National Company Law Tribunal), Mumbai Bench under Section 9 of IBC for initiation of corporate insolvency resolution process against the Respondent, which was dismissed on the grounds that the application was barred by limitation. The Appellant filed the present appeal against this order.

Contentions:

The Appellant contended that since an Arbitration Application was pending, the recovery of debt was not barred by limitation. The Respondent claimed that the Arbitration Application was dismissed in 2014 and that the debt recovery application was time barred as the debt claimed related to September 2011. Hence the debt claimed by the Appellant was said to be time-barred, and the Respondent relied upon the definition of debt under Section 3(11) of IBC which states that when a debt is time-barred, there is no legal obligation on the Respondent to pay the same. The Appellant however, relying on the *Neelkanth Township* case (*discussed in L&S Corporate Amicus, October 2017*), contented that the law of Limitation is not applicable to IBC.

Observations:

The NCLAT, in response to the Appellant's contention, found that the Supreme Court in the *Neelkanth Township* case had left this question of law open, i.e. whether Limitation Act is applicable to IBC or not, and no ruling had been passed in respect of the same. With regards to the question of the present application being time-barred, NCLAT noted that Article 137 of the Limitation Act would be applicable in such a case. Article 137 provides for a 3 year limitation period from the time the right to apply accrues. The court observed that the IBC came into force on 1st December 2016, hence the right to apply accrued on 1st December 2016. Therefore, assuming that the Limitation Act is applicable to IBC, the appeal shall still not be held to be barred by limitation.

Judgment:

NCLAT, while allowing the appeal, held that the Adjudicating Authority was incorrect in dismissing the application on the grounds of it being time-barred. Thus, the order of the Adjudicating Authority cannot be sustained in law and was set aside. The NCLAT remitted the case back to the Adjudicating Authority, directing it to pass a reasonable order after hearing the Parties.

Analysis:

NCLAT has provided a broader application of the Limitation Act in IBC proceedings. This judgment will give the Parties confidence to file cases for recovery of their debt, even under the assumption of it being time-barred. This judgement however, does not clarify the status of the application of Limitation Act in IBC as it merely provides an opportunity to creditors to file a claim for debt recovery before December 2019, i.e. three years from the date of enactment of IBC. [*Black Pearl Hotels (Pvt) Ltd.* v. *Planet M Retail Ltd.* - Company Appeal (AT) (Insolvency) No. 91 of 2017, Order dated 4-5-2017 of National Company Law Appellate Tribunal, Mumbai]

Contract should be interpreted in accordance with terms expressly provided therein – SC rules on when express term can be implied

Brief Overview:

The Supreme Court has held that a contract should be interpreted in accordance with the terms expressly provided in its agreement. A term can only be implied to be present in the contract if it is necessary to give efficacy to the business transaction.

Facts:

The Punjab State Electricity Board (PSEB) conducted a competitive bidding for the procurement of electricity from a power station, to be set up in Rajpura, District Patiala, Punjab. The bidder was to enter into a 25-year Power Purchase Agreement (PPA) with PSEB.
Immediately after executing the contract, a dispute arose with respect to interpretation of the clauses of the PPA. The dispute related to bearing the cost of washing the coal which is required for power generation, and whether the cost of such coal has to be determined based on the purchase price from SECL at the mine-end, or at the project-end.

Contentions:

The Appellant contended that the reference to coal and fuel in the PPA, only refers to washed coals, and thus the cost of transporting, unloading and purchasing must include the cost of washed coal. The Appellants further contended, that the pre-bid clarification, which stated that the successful bidder would arrange for washing the coal, does not imply that the washing cost was to be borne by the Appellant. The terms of the PPA provided for a formula to expressly calculate the actual cost incurred to be reimbursed. The Appellant contends that the request for proposal, only referred to the cost towards operating and maintaining the power plant and not the cost associated with the cost of coal, which is a part of the energy charges. The Respondents however claimed that there are only three distinct identifiable components of coal recognized for tariff, namely a) purchase; b) transportation; c) unloading and, until and unless the claims fall under these heads, they cannot be reimbursed. The Respondent further stated that the coal supplied would not be washed, and that the obligation of washing would lie on the Appellant.

Observations:

The Court observed that, as per the formula in the PPA the cost of the coal is the actual cost of purchasing unwashed coal, transporting and unloading washed coal, supplied at the Project. Thus, the fact that Appellant had to arrange the washing of coal, does not imply that the Appellant must bear the cost of washing. The court interpreted the document by reading the contract on the face of it and held that washed coal is a necessity for the project to maintain quality and thus includes all the relevant costs to achieve the required quality. The mere term coal, thus would have to mean washed coal, as no other type of coal is useful in the matter at hand.

Judgment:

The Supreme Court held that:

a) The calorific value of the coal was to be ascertained at the Project site, and all costs of the coal up to the point of the Project site should be included in the calorific value of the coal.
b) The formula in the PPA only contains three elements under which the Appellant maybe reimbursed. Thus, reading the expressed terms of the PPA, the Appellant cannot be allowed to plead under any other element.
c) The appeal was partly allowed to the extent that the Appellant was held entitled to the washing cost of coal, transportation from mine site where it was necessary. All the other claims in the appeal were rejected by the Supreme Court.

Analysis:

The Supreme Court held that normally a contract should be read as it reads, *per* its express terms provided in the contract. The reading of the implied terms in a concept is necessitated only when the five-point test comes into play i.e.

(1) It must be reasonable and equitable;
(2) It must be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it;
(3) It must be so obvious that "it goes without saying";
(4) It must be capable of clear expression;
(5) It must not contradict any express term of the contract. There must be a strict necessity for it.

An express term can be implied if and only if the court finds that the parties intended that term to form a part of that contract. Merely because parties to a contract would have adopted a particular term is not enough for the Courts to imply such term in the contract. In the present case, the Hon'ble Supreme Court interpreted the literal meaning of terms of the contract. [*Nabha Power Ltd. (NPL)* v. *Punjab State Power Corporation* - Civil Appeal No. 179/2017 decided on 5-10-2017, Supreme Court - MANU/SC/1291/2017]

Counter-guarantee is an independent contract, separate from its underlying contract

Brief Overview:

The High Court of Delhi has held that a counter-guarantee is an independent contract, separate from its underlying contract. The Court upheld that the intentions of the parties were paramount to determining jurisdiction, and a mere omission of a technical term such as 'only' would not be enough to render the jurisdiction as non-exclusive.

Facts:

In this case the Appellant entered into a contract with the Respondent at Ankara on April 21, 2015. As required by the contract, AKBank T.A.S. had furnished a performance bank guarantee to the Respondent. Bank of Baroda furnished a counter bank guarantee in favour of AKBank T.A.S. for the same amount. Disputes arose between the Appellant and the Respondent, and the Respondent invoked the bank guarantee. The Appellant filed a suit for restraining encashment of the bank guarantee, and an interim injunction was passed. The Appellant claimed that though the performance bank guarantee was governed by English law and had conferred exclusive jurisdiction upon the Commercial Court at London, it was impossible for the Appellant to seek relief in respect of the bank guarantees in London at such short notice. An order was passed on September 5, 2017 stating that the admissions of the Appellant were questions of fact and not law, and hence inadmissible. A second order, filed by the two banks, held that the jurisdiction was exclusively conferred upon the Commercial Court at London.

Contentions:

The Appellant submitted that the courts would normally give effect to the intention of the parties as expressed in the agreement, except when there are strong reasons to justify disregarding the contractual obligations of the parties. Appellant accordingly submitted that as the two banks, namely, AKBank T.A.S. and Bank of Baroda were already present before the Delhi High Court, therefore the Delhi High Court would be the *forum conveniens* and court of natural jurisdiction.

Observations:

The Court observed that the independence of a contract for guarantee simply means that the dispute concerning the bank guarantee has to be resolved in terms of the bank guarantee. A court may only injunct a bank guarantee in one of three situations, namely, fraud which vitiates the very foundation of the bank guarantee, special equities and irretrievable injury. The Court further observed that when the intention of the parties was clear and unambiguous with reference to jurisdiction of the courts, it has to be accepted.

Judgment:

The Court, thus, upheld the order passed on the September 19, 2017, holding that the counter bank guarantee given by the Bank of Baroda in favour of AKBank T.A.S. confers jurisdiction on the Commercial Courts at London and, therefore, excludes jurisdiction of other courts. Further, the performance bank guarantee was given by AKBank T.A.S. in Turkey and not in or from India. Thus, the Courts in India had no territorial jurisdiction, and the appeal was accordingly dismissed.

Analysis:

This judgment provides a critical understanding of the effect of exclusive territorial jurisdiction in commercial contracts, particularly in separate agreements from the underlying contract, which may have distinct dispute resolution provisions. In refusing to confer jurisdiction on the Indian courts, and aligning with the fact that the contracts vested jurisdiction outside India, the Court upheld the principle that the intention of the parties is essential, and cannot be abrogated. [*Bharat Heavy Electricals Limited* v. *Electricity Generation Incorporation and Ors.* - FAO(OS) (COMM) 184 and 185/2017, decided on 17-10-2017, Delhi High Court - MANU/DE/3372/2017]

Non-allotment of shares does not amount to 'financial debt' under IBC

Brief Overview:

NCLT has held that non-allotment of shares does not amount to *'financial debt'* under IBC.

Facts:

ACPC Enterprises (Petitioner) had executed a Share Subscription Agreement (SSA) with Affinity Beauty Salon Pvt. Ltd. (Respondent) on 4th June, 2016. The SSA envisaged the transfer of 2,50,000 Cumulative Convertible Redeemable Preference Shares (CCRPS) to the Petitioner for a consideration of Rs. 2,50,00,000/-. The said consideration was duly received by the Respondent from the Petitioner, and requisite share certificates were issued to the Petitioner. Later, the Respondent claimed that the CCPRS issued were not registered with the ROC in favour of the Petitioner, since the Petitioner was an unregistered partnership firm. Consequently, the Petitioner got itself registered with the Registrar of Firms.

However, even upon expiry of 60 days after the receipt of the consideration, CCRPS were not issued to the Petitioner. Then, a letter cum notice was sent by the Petitioner to the Respondent that if the CCRPS were not duly issued and registered with the ROC within 7 days from receipt of the said letter, then the consideration paid by the Petitioner would be treated as a debt payable with interest thereon. Post receipt of the said letter cum notice, the Respondent sold its business and offered to allot the CCRPS to the Petitioner. However, the Petitioner claimed that due to sale of business by the Respondent, the CCRPS had become drastically devalued, thereby refused to accept the allotment of CCRPS.

Decision:

The NCLT held that share subscription money paid for the purchase of shares could not be considered as a *'Financial Debt'* as the amount had not been given against consideration of time value of money nor was it borrowed against payment of interest. Instead, the consideration in the instant matter was given against allotment of shares. It was therefore held that *'every debt is not essentially a financial debt.'*

Analysis:

By virtue of this decision, share subscription money shall not amount to *'financial debt'* under IBC and a purchaser of such shares would not satisfy the definition of 'financial creditor' under IBC. [*ACPC Enterprises* v. *Affinity Beauty Salon Pvt. Ltd.* - (IB)-352 (PB)/2017, Order dated 10-11-2017, NCLT (Delhi) Principal Bench]

Arbitration Proceedings cannot be initiated post declaration of moratorium under IBC

Key Points:

Arbitration proceedings instituted after the declaration of moratorium under Section 14 of the IBC will be considered as '*non est*' in law and therefore, such arbitration proceeding cannot be instituted.

Facts:

Corporate insolvency resolution process of a corporate debtor (i.e. Respondent) was admitted by the NCLT pursuant to an application filed by the financial creditor (i.e. Petitioner) and the NCLT declared moratorium under Section 14 of the IBC. While the moratorium was in force, the parties invoked the arbitration clause, pursuant to which a sole arbitrator was appointed. Subsequently, the NCLT directed that no arbitration proceedings could be continued when a moratorium has been declared under the IBC.

In light of the above, an appeal was filed before the District Court of Rajasthan under Section 37 of the Arbitration and Conciliation Act, 1996, for directing initiation of arbitration proceedings. The appeal was subsequently admitted by the District Court of Rajasthan. Vide Order dated 6-7-2017, the appeal was asked to be registered and notice was issued awaiting a reply ("Order"). The issue before the Supreme Court of India was whether arbitration proceedings can be instituted after the declaration of moratorium under the IBC.

Observations of the Court:

The Court emphasized that it is the mandate under the IBC that the moment an application for insolvency resolution process is admitted by the NCLT, the moratorium comes into effect by virtue of Section 14 of IBC and such moratorium expressly prohibits institution or continuation of pending suits or proceedings against the corporate debtor.

Judgement:

The Court set aside the Order and held that the arbitration proceedings instituted after the declaration of moratorium to the corporate debtor under the IBC is *non est* in law. The appeal was allowed holding that the steps to be taken under the IBC will continue unimpeded by any order of any other court. [*Alchemist Asset Reconstruction Company Ltd.* v. *Hotel Gaudavan Pvt. Ltd. & Ors.,* - Civil Appeal No. 16929 of 2017, Judgment dated 23-10-2017, Supreme Court of India]

Notice issued by Law Firm on behalf of Operational Creditor when not a demand notice

Key Points:

Demand notice to a corporate debtor under Section 8 of the Insolvency and Bankruptcy Code, 2016 ("IBC") is required to be issued only by the operational creditor or person authorised by the operational creditor and such person authorised by the operational creditor must hold position with, or in relation to, the operational creditor.

Facts:

The operational creditor i.e. the Respondent issued a demand notice through a law firm to the corporate debtor i.e. the Appellant for recovery of an operational debt. The Corporate Debtor in its reply to the demand notice requested the Operational Creditor to follow the procedures as per agreement entered into between the Operational Creditor and the Corporate Debtor, by appointing nominee arbitrator. The Operational Creditor through the Law Firm had also issued a demand notice to the Corporate Debtor under Rule 5 of the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016 ("Rules").

On failure of the Corporate Debtor to repay the operational debt owed to the Operational Creditor, the Operational Creditor filed an application to initiate insolvency resolution process against the Corporate Debtor before the National Company Law Tribunal, Chennai ("NCLT"), under Section 9 of the IBC. The NCLT admitted the application, and appointed an interim resolution professional and declared moratorium along with further directions in terms of the IBC, which was challenged by the Corporate Debtor before the National Company Law Appellate Tribunal, New Delhi ("NCLAT").

The issue before the NCLAT is whether demand notice issued by the Law Firm on behalf of the Operational Creditor is in accordance with the provisions of the IBC.

Observations of NCLAT:

The NCLAT relying on an earlier case[1], observed that in terms of Section 8 of the IBC read with Rule 5 of the Rules, an operational creditor can apply himself or through a person authorised to act on its behalf and such authorised person of the operational creditor must hold position with, or in relation to, the operational creditor.

The NCLAT noted that, in the present case, (i) the Law Firm which sent the demand notice to the Corporate Debtor had not been authorised by the board of directors of the Operational Creditor to issue such notice under Section 8 of the IBC and (ii) the Law Firm which sent the demand notice to the Corporate Debtor did not hold position with, or in relation to, the Operational Creditor.

Order:

The NCLAT held that the notice issued by the Law Firm on behalf of the Operational Creditor cannot be treated as a demand notice in terms of the requirements under Section 8 of the IBC and accordingly, the application for initiation of insolvency resolution process against the Corporate Debtor under the IBC is not maintainable.

Concluding Remarks:

A demand notice issued by an operational creditor to a corporate debtor under Section 8 of the IBC is a significant requirement and the same should be served to the corporate debtor in the manner prescribed under the IBC, otherwise, the operational creditor cannot proceed with the application for corporate insolvency resolution process. [*Smartcity (Kochi) Infrastructure Pvt. Ltd.* v. *Synergy Property Development Services Pvt. Ltd. & Anr.* - Company Appeal (AT) (Insol.) No. 80 of 2017, Judgment dated 12-10-2017, NCLAT]

[1] *Uttam Galva Steels Ltd*. v. *DF Deutsche Forfait AG & Anr.* [Company Appeal (AT) (Insolvency) No. 39 of 2017].

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