NEWSLETTER
Legal, Compliance and ESG

05 December 2019

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A) LEGAL AND REGULATORY UPDATES:

I. RBI Update: Withdrawal of Exemptions - Housing Finance Institutions[1]

The Reserve Bank of India ("RBI"), vide notification dated November 11, 2019, has withdrawn the exemption granted to Housing Finance Institution from the applicability of Chapter IIIB of the RBI Act, 1934, except the exemption from section 45-IA of the RBI Act.

Chapter IIIB of the RBI Act relates to provisions relating to 'non-banking institutions and receiving deposits and financial institutions', and under the said chapter, section 45-IA regulates the registration and net-owned funds requirement for an NBFC.

II. Insolvency Resolution and Liquidation Proceedings of Non-Banking Finance Companies[2]

In exercise of the powers conferred by Section 227 of the Insolvency and Bankruptcy Code, 2016 (the "Code"), the Central Government in consultation with RBI has notified that insolvency resolution and liquidation proceedings of non-banking finance companies (which include housing finance companies) with asset size of Rs.500 crore or more, as per last audited balance sheet shall be undertaken in accordance with the provisions of the

1 https://rbidocs.rbi.org.in/rdocs/notification/PDFs/NOTI982517579395D748DCB063F8336CB3BD96.PDF

2 http://www.mca.gov.in/Ministry/pdf/NotificationFSPs_18112019.pdf

Code read with the Insolvency and Bankruptcy (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to Adjudicating Authority) Rules, 2019 and the applicable Regulations. The appropriate regulator for such entities shall be the RBI.

III. SEBI: Press Release dated 20th November 2019[3]

SEBI in its Board Meeting held on November 20, 2019 has taken certain key decisions and has proposed amendments under various Regulations which shall be applicable from January 1, 2020:

The key changes pertain to:

1. Review of Right issue process

The key proposals approved by the Board are as follows:

- reduction in the timeline for completion of the Rights Issue from the current T+55 days to T+31 days;
- introduction of dematerialized REs and trading of REs on stock exchange platform;
- shareholders holding shares in physical form will be required to provide details of demat account for credit of REs;
- ASBA facility made mandatory for all investors applying to Rights Issue.

2. Extension of the requirement of Business Responsibility Report to top 1000 by market capitalization

3. Issuance of SEBI (Portfolio Managers) Regulations, 2019

The salient features of the proposed SEBI (Portfolio Managers) Regulations, 2019 (to replace the SEBI (Portfolio Managers) Regulations, 1993) are:

- To enhance the eligibility criteria and to define the role of Principal Officer clearly. The enhanced eligibility criteria to be applicable to any employee with decision making authority relating to management of the clients' portfolios.
- A Portfolio Manager to mandatorily employ minimum one person with defined eligibility criteria in addition to Principal Officer and Compliance Officer.
- Net-worth requirement of Portfolio Managers to be enhanced from INR 2 Crores to INR 5 Crores. Existing Portfolio Managers to meet the enhanced requirement within 36 months.
- Minimum investment by clients of Portfolio Managers to be increased from INR 25 lakhs to INR 50 lakhs. Existing investments of clients may continue as such till end date of the PMS Agreement or as specified by the Board.
- Discretionary Portfolio Managers to invest only in listed securities, money market instruments, units of Mutual Funds and such other securities/ instruments as specified by SEBI from time to time.
- Non-discretionary/ Advisory Portfolio Managers to invest not more than 25% of their AUM in unlisted securities.
- To make the appointment of custodian mandatory for all the Portfolio Managers except for those providing only advisory services to clients.
- To restrict off market transfers from/to clients' accounts with

[3] https://www.sebi.gov.in/media/press-releases/nov-2019/sebi-board-meeting_45022.html

certain exceptions to facilitate operational convenience.

4. Disclosure by listed entities of defaults on payment of interest / repayment of principal amount on loans from banks / financial institutions: In order to address the gaps in availability of information with respect to defaults, the Board has, inter-alia, decided that in case of any default in repayment of principal or interest on loans from banks or financial institutions which continues beyond 30 days from the pre-agreed payment date, listed entities shall, promptly, but not later than 24 hours from the 30th day, disclose the fact of such default.

IV. The Insolvency and Bankruptcy (Application to Adjudicating Authority for Bankruptcy Process for Personal Guarantors to Corporate Debtors) Rules, 2019[4]

MCA vide its notification dated November 15, 2019 has notified the Insolvency and Bankruptcy (Application to Adjudicating Authority for Insolvency Resolution Process for Personal Guarantors to Corporate Debtors) Rules, 2019. These rules shall apply to insolvency resolution process for personal guarantors to corporate debtors.

Key highlight of these rules are as follows:

Application by guarantor -

1. The application under sub-section (1) of section 94 shall be submitted in Form A, along with an application fee of two thousand rupees.
2. The guarantor shall serve forthwith a copy of the application referred as above to every financial creditor and the corporate debtor for whom the guarantor is a personal guarantor.

Application by creditor -

1. A demand notice under clause (b) of sub-section (4) of section 95 shall be served on the guarantor demanding payment of the amount of default, in Form B.
2. The application under sub-section (1) of section 95 shall be submitted in Form C, along with a fee of two thousand rupees.
3. The creditor shall serve forthwith a copy of the application referred to in sub-rule (2) to the guarantor and the corporate debtor for whom the guarantor is a personal guarantor.
4. In case of a joint application, the creditors may nominate one amongst themselves to act on behalf of all the creditors.

The applicant shall provide a copy of the application filed under sub-section (1) of section 94 or sub-section (1) of section 95, as the case may be, if not provided earlier, to the resolution professional within three days of his appointment under sub-section (5) of section 97, and to the Board for its record.

Withdrawal of application –

1. The Adjudicating Authority may permit withdrawal of the application submitted under rule 6 or rule 7, as the case may be, (a)before its admission, on a request made by the applicant; (b)after its admission, on the request made by the applicant, if ninety per cent. of the creditors agree to such withdrawal.
2. An application for withdrawal under clause (b) of sub-rule (1) shall be in Form D.

4 http://www.mca.gov.in/Ministry/pdf/FinalIRPRules_15112019.pdf

B) Committee of Creditors (CoC) of Essar Steel India Limited vs. Satish Kumar Gupta & Ors.[5]

National Company Law Appellate Tribunal (NCLAT) sent shocking waves in the lending community by its verdict passed on August 2019 stating that –

1. *"in a resolution plan there can be no difference between a financial creditor and an operational creditor in the matter of payment of dues, and that therefore, financial creditors and operational creditors deserve equal treatment under a resolution plan; and*

2. *The Committee of Creditors has not been empowered to decide the manner in which the distribution is to be made between one or other creditors, as there would be a conflict of interest between financial and operational creditors, financial creditors favouring themselves to the detriment of operational creditors."*

Now, the Supreme Court has reversed NCLAT's ruling in its recent landmark judgment and held, inter-alia, the following:

1. Main object of Insolvency and Bankruptcy Code is resolution of the corporate borrower;
2. There is no equality between financial creditors and operational creditors;
3. NCLT/NCLAT cannot substitute the commercial wisdom of the Committee of Creditors and cannot interfere with its commercial decisions; and
4. Equitable treatment is to be accorded to each creditor depending upon the class to which it belongs: secured or unsecured, financial or operational.

APAC Comment: The Supreme Court and other recent ruling indicate that even if a lender has specific security, if the Borrower goes for resolution under IBC as approved by the majority of financial creditor, we are bound their decision which at times may involve sacrificing our exclusive security in the interest of the resolution and revival of the borrower. However, in case of liquidation without any resolution, exclusive security in favour of a specified lender would be protected.

The following are the other key observations of the Supreme Court.

1. It is the commercial wisdom of the majority of creditors which is to determine, through negotiation with the prospective resolution applicant, as to how and in what manner the corporate resolution process is to take place.
2. What is left to the majority decision of the Committee of Creditors is the "feasibility and viability" of a resolution plan, which obviously takes into account all aspects of the plan, including the manner of distribution of funds among the various classes of creditors
3. When the Committee of Creditors exercises its commercial wisdom to arrive at a business decision to revive the corporate debtor, it must necessarily take into account the key features of the Code before it arrives at a commercial decision to pay off the dues of financial and operational creditors.
4. The decision of the Committee of Creditors must reflect the fact that it has taken into account maximising the value of the assets of the corporate debtor and the fact that it has adequately balanced the interests of all stakeholders including operational creditors.

[5] https://www.ibbi.gov.in/uploads/order/d46a64719856fa6a2805d731a0edaaa7.pdf

5. While the Adjudicating Authority cannot interfere on merits with the commercial decision taken by the Committee of Creditors, the limited judicial review available is to see that the Committee of Creditors has taken into account the fact that the corporate debtor needs to keep going as a going concern during the insolvency resolution process, that it needs to maximise the value of its assets; and that the interests of all stakeholders including operational creditors has been taken care of Financial creditors are in the business of lending money and they earn profit by earning interest on money lent with low margins. Financial creditors are capital providers for companies, who in turn are able to purchase assets and provide a working capital to enable such companies to run their business operation. Operational creditors are beneficiaries of amounts lent by financial creditors which are then used as working capital, and often get paid for goods and services provided by them to the corporate debtor, out of such working capital. The business risk of operational creditors who operate with higher profit margins and shorter cyclical repayments must needs be higher.
6. Operational creditors have an immediate exit option, by stopping supply to the corporate debtor, once corporate debtors start defaulting in payment. Financial creditors may exit on their long-term loans, either upon repayment of the full amount or upon default, by recalling the entire loan facility and/or enforcing the security interest which is a time consuming and lengthy process which usually involves litigation. Financial creditors are also part of a regulated banking system which involves not merely declaring defaulters as non-performing assets but also involves restructuring such loans which often results in foregoing unpaid amounts of interest either wholly or partially.
7. Fair and equitable dealing of operational creditors' rights under the said Regulation involves the resolution plan stating as to how it has dealt with the interests of operational creditors, which is not the same thing as saying that they must be paid the same amount of their debt proportionately.
8. The fact that the operational creditors are given priority in payment over all financial creditors does not lead to the conclusion that such payment must necessarily be the same recovery percentage as financial creditors.
9. So long as the provisions of the Code and the Regulations have been met, it is the commercial wisdom of the requisite majority of the Committee of Creditors which is to negotiate and accept a resolution plan, which may involve differential payment to different classes of creditors, together with negotiating with a prospective resolution applicant for better or different terms which may also involve differences in distribution of amounts between different classes of creditors.
10. By vesting the Committee of Creditors with the discretion of accepting resolution plans only with financial creditors, operational creditors having no vote, the Code itself differentiates between the two types of creditors for the reasons given above.
11. The equality principle cannot be stretched to treating unequals equally, as that will destroy the very objective of the Code - to resolve stressed assets. Equitable treatment is to be accorded to each creditor depending upon the class to which it belongs: secured or unsecured, financial or operational.
12. It is clear that it is the commercial wisdom of the Committee of Creditors that is free to determine what amounts be paid to different classes and sub-classes of creditors in accordance with the provisions of the Code and the Regulations made thereunder The Committee of Creditors does not act in any fiduciary capacity to any group of creditors. On the contrary, it is to take a business decision based upon ground realities by a majority, which then binds all stakeholders, including dissentient creditors.

C) ESG: UNDERSTANDING THE MEANING OF HOSTILE SEXUAL ENVIRONMENT IN ACCORDANCE WITH THE SEXUAL HARASSMENT OF WOMEN AT WORKPLACE (PREVENTION, PROHIBITION AND REDRESSAL) ACT, 2013

While some forms of sexual harassment such as sexual assault are inherently offensive and egregious and may need to occur only once for it to be treated as 'sexual harassment', some other forms may not be easily distinguishable. Since there is no fine line test in determining what would amount to a 'hostile working environment', the burden will lie on the Internal Committee to decide whether the harassment suffered by a victim is sufficiently severe to have created a hostile working environment or not. Further, determining what constitutes 'sexual harassment' depends upon the specific facts and the context in which the conduct has occurred.

Hostile environment sexual harassment occurs when either speech or conduct of a sexual nature takes place and is seen or perceived as offensive and interferes with the work performance of the recipient, or any one or more associates.

KEY ELEMENTS OF HOSTILE WORK ENVIRONMENT

- Is the harassing behavior offensive enough create an abusive work environment
- The frequency of conduct
- If the behavior interferes with work performance
- If the alleged harassment is intimidating, threatening, or humiliating or just an overreaction or sole instance.

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Case Law:

In the case of K.P. Anil Rajagopal v. State of Kerela, Kerela High Court ((2018) 1 KLJ 106): In this case the High Court observed that the act or behavior must be connected with sexual harassment including allegations of promise, threat or an offensive or hostile work environment towards female employees. A solitary allegation of intemperate language against a female employee in a report does not constitute an offence under the Act. This was because there was no allegation of a promise, threat or creation of an offensive or hostile work environment for the female employee.

Any such act should be connected with and in relation to any act or behaviour of sexual harassment. The complaint is that the allegation in the report was only to harass the complainant which cannot constitute a sexual harassment merely because it was made against a female employee. If such complaints are allowed to be made under the Act of 2013, then, there could be no independent report made against any women employee in any organisation and no controlling authority would be able to properly supervise the work of a female employee.