NEWSLETTER

Legal, Compliance and ESG

05 March 2020

Dear Readers,

We bring to your reading and attention following topics:

A) LEGAL AND REGULATORY UPDATES:

I. SARFAESI Update[1]

Government of India, Ministry of Finance in exercise of the powers conferred by Section 2 (1) (m) (iv) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) vide notification dated February 24, 2020 notified that non-banking financial companies as defined in section 45-I (f) of the Reserve Bank of India Act, 1934 having assets worth Rs.1,00,00,00,000 (Rupees One Hundred Crores) and above, shall be entitled for enforcement of security interest in secured debts of Rs.50,00,000 (Rupees Fifty Lakhs) and above, as financial institutions for the purposes of the SARFAESI Act.

II. RBI Update - Micro, Small and Medium Enterprises (MSME) sector – Restructuring of Advances[2]

With reference to the circular DBR.No.BP.BC.18/21.04.048/2018-19 dated January 1, 2019, it has been decided to extend the one-time restructuring of MSME

1 https://financialservices.gov.in/sites/default/files/NBFC%20NOTIFICATION%20DATED%2024.2.2020.pdf

2 https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11445&Mode=0

advances permitted in terms of the said circular. Accordingly, a one-time restructuring of existing loans to MSMEs classified as 'standard' without a downgrade in the asset classification is permitted, subject to the following conditions:

i. The aggregate exposure, including non-fund based facilities, of banks and NBFCs to the borrower does not exceed ₹25 crore as on January 1, 2020.
ii. The borrower's account was in default but was a 'standard asset' as on January 1, 2020 and continues to be classified as a 'standard asset' till the date of implementation of the restructuring.
iii. The restructuring of the borrower account is implemented on or before December 31, 2020.
iv. The borrowing entity is GST-registered on the date of implementation of the restructuring. However, this condition will not apply to MSMEs that are exempt from GST-registration. This shall be determined on the basis of exemption limit obtaining as on January 1, 2020.

It is clarified that accounts which have already been restructured in terms of the circular dated January 1, 2019 shall be ineligible for restructuring under this circular.

All other instructions specified in the circular shall be applicable.

III. Companies (Auditor's Report) Order, 2020. [3]

In exercise of the powers conferred by sub-section (11) of section 143 of the Companies Act, 2013 and in supersession of the Companies (Auditor's Report) Order, 2016, the Central Government, after consultation with the National Financial Reporting Authority constituted under section 132 of the Companies Act, 2013, has made the Companies (Auditor's Report) Order, 2020.

B) Supreme Court: No provision under the IBC requiring the resolution plan to match liquidation value; and an approved resolution plan cannot be withdrawn under Section 12A of the IBC

The Supreme Court (**"SC"**) has by its judgement *(decided on January 22, 2020)* held that there is no provision in the Insolvency and Bankruptcy Code, 2016 (**"IBC"**) that requires a resolution plan to match the liquidation value of the assets of the corporate debtor and that an approved resolution plan cannot be withdrawn by a successful resolution applicant under Section 12A of the IBC.

Facts

M/s. Maharashtra Seamless Limited (**"Appellant"**) was a successful resolution applicant in the corporate insolvency resolution process involving United Seamless Tubulaar Private Limited (**"Corporate Debtor"**) and its creditors. The total debt of the Corporate Debtor was INR 1,897

3 http://www.mca.gov.in/Ministry/pdf/Orders_25022020.pdf

crores, comprising of term loans aggregating to INR 1,652 crores availed from two entities of Deutsche Bank, and a working capital loan of INR 245 crores taken from an Indian Bank, which was also the initiator of the corporate insolvency resolution process before the National Company Law Tribunal, Hyderabad (**"Adjudicating Authority"**). Under an order dated January 21, 2019, the Adjudicating Authority approved the resolution plan submitted by the Appellant (**"Resolution Plan"**). The Resolution Plan included upfront payment of INR 477 crores by the resolution applicant, that is, to the financial creditors, operational creditors and other creditors of the Corporate Debtor, as per the ratio suggested therein. Ancillary directions were issued by the Adjudicating Authority while giving its approval to the said Resolution Plan and observing that the said plan met all the requirements of Section 30(2) of the IBC. The aforesaid order passed by the Adjudicating Authority was however, taken up in appeal before the National Company Law Appellate Tribunal (**"NCLAT"**) by one of the promoters of the Corporate Debtor, by the name Padmanabhan Venkatesh, and the Indian Bank (**"Respondents"**). The Appellant herein had also preferred an appeal before the NCLAT challenging the order of the Adjudicating Authority dated February 28, 2019, on the ground that it was not given access to the assets of the Corporate Debtor.

Under a common order dated April 8, 2019, dealing with all the three aforementioned appeals, the NCLAT held that the Appellant should increase the upfront payment from INR 477 crores, as proposed under the Resolution Plan, to INR 597.48 crores, to make it at par with the average liquidation value of INR 597.54 crores and that such increased amount should be paid in the same ratio as suggested in the Resolution Plan. The NCLAT further held that if the Appellant failed to undertake the payment of the additional amount and deposit it in an escrow account within thirty days, the impugned order of approval of the Resolution Plan was to be treated as having been set aside. The said order of the NCLAT was appealed against by the Appellant in the instant case before the SC on April 23, 2019. Similarly, the financial creditor, DB International (Asia Limited) also filed an appeal against the aforesaid order of the NCLAT on May 1, 2019 before the SC. In addition to the appeal, an Interlocutory Application (**"IA"**) was filed by the Appellant before the SC on August 2, 2019, seeking refund of the sum deposited by it in terms of the Resolution Plan along with interest, and withdrawal of the Resolution Plan. The Appellant's grievance was that in order to take over the Corporate Debtor it had availed of a substantial term loan facility and deposited the sum of INR 477 crores for resolution of the Corporate Debtor in a designated escrow account on February 19, 2019, but due to delay in implementation of the Resolution Plan, it was compelled to bear the interest burden. Also, the export orders it had accepted in anticipation of successful implementation of the Resolution Plan were cancelled, as a result of which the takeover of the Corporate Debtor had become untenable.

Issues

(i) Whether the scheme of the IBC contemplates that the sum forming part of the Resolution Plan should match the liquidation value or not.

(ii) Whether Section 12A of the IBC is the applicable route through which a successful resolution applicant can retreat.

Arguments

<u>Contentions raised by the Appellant:</u>

The Appellant, *inter alia*, contended that the NCLAT had exceeded its jurisdiction in directing matching of the liquidation value in the Resolution Plan. The Appellant further contended that the final decision on the Resolution Plan should be left to the commercial wisdom of the

committee of creditors and there is no requirement that the Resolution Plan should match the maximized asset value of the Corporate Debtor. Additionally, the counsel for DB International (Asia Limited), while supporting the main appeal of the Appellant, resisted the plea of the Appellant for withdrawal of the Resolution Plan and refund of the sum already remitted. On the aspect of withdrawal of the Resolution Plan, the counsel for the financial creditors submitted that the only route through which a resolution applicant can travel back after admission of the Resolution Plan was as per Section 12A of the IBC.

Contentions raised by the Respondents:

The Respondents' primary contention was that approval of the Resolution Plan, under which the assets of the Corporate Debtor were valued at INR 477 crores, would ultimately entitle the Appellant to excessive gains as it would get assets valued at INR 597.54 crores at a much lower amount. They emphasized that there could be no reason to release the property valued at INR 597.54 crores to the Appellant at INR 477 crores. One of the Respondents further contended that another resolution applicant, namely, Area Projects Consultants Private Limited, had made a revised offer of INR 490 crores, which was more than the amount offered by the Appellant.

Observations of the Supreme Court

The SC noted that, in the course of appeal before the NCLAT, substantial argument was also advanced over failure on part of the Adjudicating Authority to maintain parity between the financial creditors and the operational creditors on the aspect of clearing dues. Thereafter, the SC referred to Section 30(2)(b) of the IBC which specifies the manner in which a resolution plan shall provide for payment to the operational creditors. The SC also referred to the decision dated November 15, 2019, of a co-ordinate bench of the SC in the case of ***Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta [Civil Appeal Nos. 8766-8767],*** which dealt with the manner of handling claims of operational creditors in a corporate insolvency resolution process. The co-ordinate bench of the SC had observed that there is no doubt that a key objective of the IBC is to ensure that the corporate debtor keeps operating as a going concern during the insolvency resolution process and must therefore make past and present payments to its operational creditors, without which such operation as a going concern would become impossible. On the point of dealing with claims of the operational creditors, the SC, referring to the aforementioned judgment, held that the UNCITRAL Legislative Guide makes it clear beyond any doubt that equitable treatment is only of similarly situated creditors and that there is a difference in payment of the debts of financial creditors and operational creditors, with operational creditors having to receive a minimum payment, being not less than the liquidation value, which does not apply to financial creditors. However, since none of the operational creditors in the instant case had questioned the legality of the Resolution Plan, the SC observed that the said issue had become academic.

On the question of whether the scheme of the IBC contemplates that the sum forming part of the Resolution Plan should match the liquidation value or not, the SC delved into the text of Section 31 of the IBC which specifies the manner of approval of a resolution plan. The SC then placed reliance on Clause 35 of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (**"Regulations"**) which deals with the determination of liquidation value of the assets of the corporate debtor. The SC held that no provision in the IBC or Regulations has been brought to its notice under which the bid of any resolution applicant has to match the liquidation value arrived at in the manner

provided in Clause 35 of the Regulations. The SC stated that the object behind prescribing such valuation process is to assist the committee of creditors to take a decision on a resolution plan properly. Once a resolution plan is approved by the committee of creditors, the statutory mandate of the Adjudicating Authority under Section31(1) of the IBC is to ascertain whether the resolution plan meets the requirement of sub-sections (2) and (4) of Section 30 of the IBC. The SC held that it did not, per se, find any breach of the said provisions in the order of the Adjudicating Authority in approving the Resolution Plan. The SC further held that the NCLAT had proceeded on equitable perception rather than commercial wisdom in holding that the liquidation value was inequitable. The SC categorically stated that the NCLAT ought to cede ground to the commercial wisdom of the creditors rather than assess the Resolution Plan on the basis of quantitative analysis. The scope of interference by the Adjudicating Authority is limited to judicial review only. The SC thus, held that the NCLAT ought not to have interfered with the order of the Adjudicating Authority in directing the resolution applicant to enhance its fund inflow upfront. With respect to the IA filed by the Appellant seeking refund of the amount remitted, coupled with the plea of withdrawal of the Resolution Plan, the SC held that the exit route prescribed in Section 12A of the IBC is not applicable to a resolution applicant. The procedure envisaged in the said provision applies only to applicants invoking Sections 7, 9 and 10 of the IBC for initiation of corporate insolvency resolution process by the financial creditor, operational creditor and corporate applicant respectively. The SC further held that the Appellant having appealed against the NCLAT order with the object of implementing the Resolution Plan could not be permitted to take a contrary stand in the IA filed in connection with the very same appeal for refund of the amount remitted. The SC further observed that considering the Appellant had raised funds for implementing the Resolution Plan by mortgaging the assets of the Corporate Debtor, it would, in the said circumstance, not engage in the judicial exercise of determining the question as to whether after having been successful in a corporate insolvency resolution process, a resolution applicant altogether forfeits its right to withdraw from such process or not.

Decision of the Supreme Court

In view of the above, the SC allowed the present appeal and set aside the order of the NCLAT dated April 8, 2019. The SC affirmed the order of the Adjudicating Authority passed on January 21, 2019 which approved the Resolution Plan and directed the Appellant to remit an additional sum to the resolution professional for further remittance to the operational creditors as per their dues. Further, the IA filed by the Appellant seeking refund of the amount remitted, coupled with the plea of withdrawal of the Resolution Plan was dismissed. The SC accordingly directed the resolution professional to take physical possession of the assets of the Corporate Debtor and hand it over to the Appellant within a period of four weeks. The police and administrative authorities were directed to render assistance to the resolution professional to enable him to carry out the directions of the SC. The SC further ordered that all interim orders stand dissolved and connected applications disposed of.

The SC has, by this judgment, categorically held that there is no provision under the IBC requiring that the bid of any resolution applicant has to match the liquidation value arrived at. By endorsing the commercial wisdom of the committee of creditors in assessing the resolution scheme for the benefit of all stakeholders, the SC has clearly demarcated the scope and ambit of the adjudicating authority limiting it to only judicial review and barring interference by it in the commercial decision arrived at by the committee of creditors.

C) ESG: Difference between Oppression and Mismanagement

Sections 397 and 398 of the Companies Act, 1956 usually join those two sections and that although these two sections are often mentioned in the same breath in dealing with company matters, these are widely different sections. Section 397 seeks to prevent oppression and Section 398 seeks to prevent mismanagement.

In R. Balakrishnan And Ors. vs Vijay Dairy And Farm Products. on 18 November, 2004: A plain reading of section 397 [corresponding to Section 241(1)(a) of Companies Act, 2013] reveals that on an application made by any member of a company having the right under Section 399, complains that the affairs of the Company are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member or members, the Company Law Board may with a view to bringing to an end the matters complained of, make appropriate order, if the CLB is of opinion-

1. that the company's affairs are being conducted in a manner prejudicial to public interest or in a manner oppressive of any member or members;
2. that the facts would justify the making of a winding up order on the ground that it was just and equitable that the company should be wound up; and
3. that the winding up order would unfairly prejudice the members. It is, therefore, clear that it is for the CLB to form an opinion on the facts alleged in the petition whether the requirements of Section 397(2)(a) and (b) have been duly met before making such orders as it thinks fit under section 397.

Section 398 [corresponding to section 241(1)(b) of companies act, 2013] can be invoked in either of the following two circumstances:

i. that the affairs of the company are being conducted in a Manner which is (i) Prejudicial to public interest; or (ii) prejudicial to the interest of the company or
ii. it is likely that the affairs of the company will be conducted in a manner (i) prejudicial to public interest; or (ii) prejudicial to the interest of the company due to a material change that has taken place in the management or control of the company. Such change may take place due to alteration in the Company's Board of Directors or manager or in ownership of its shares or membership or in any other manner whatsoever.

<u>Admissibility of the petition under Oppression and Mismanagement</u>

"Every kind of oppression cannot be remedied by the court."

In Kerala High Court in the case of V. J. Thomas Vettom v. Kuttanad Rubber Co. Ltd., reported in 1984 (56) Company Cases 284. The relevant observation of the Hon'ble High Court in the said case is quoted below:

Every kind of oppression cannot be remedied by the court. Since the words used are "are being conducted", the action complained of must be a continuous one and not either an isolated or a stale one. Once the court is satisfied that the complaint is made without bonafides and to settle old scores or with the sole intention of mud-slinging, no orders under s. 397 or s. 398 will be passed. The court must have strong grounds before it to order winding up. An order under s. 397 or s. 398 can be supported only if such grounds are present.

The conduct must be burdensome, harsh and wrongful and mere lack of confidence between the majority shareholders and the minority shareholders would not be enough unless the lack of confidence springs from oppression of a minority by a majority in the management of the company's affairs, and such oppression must involve at least an element of lack of probity or fair dealing to a member in the matter of his proprietary rights as a shareholder.