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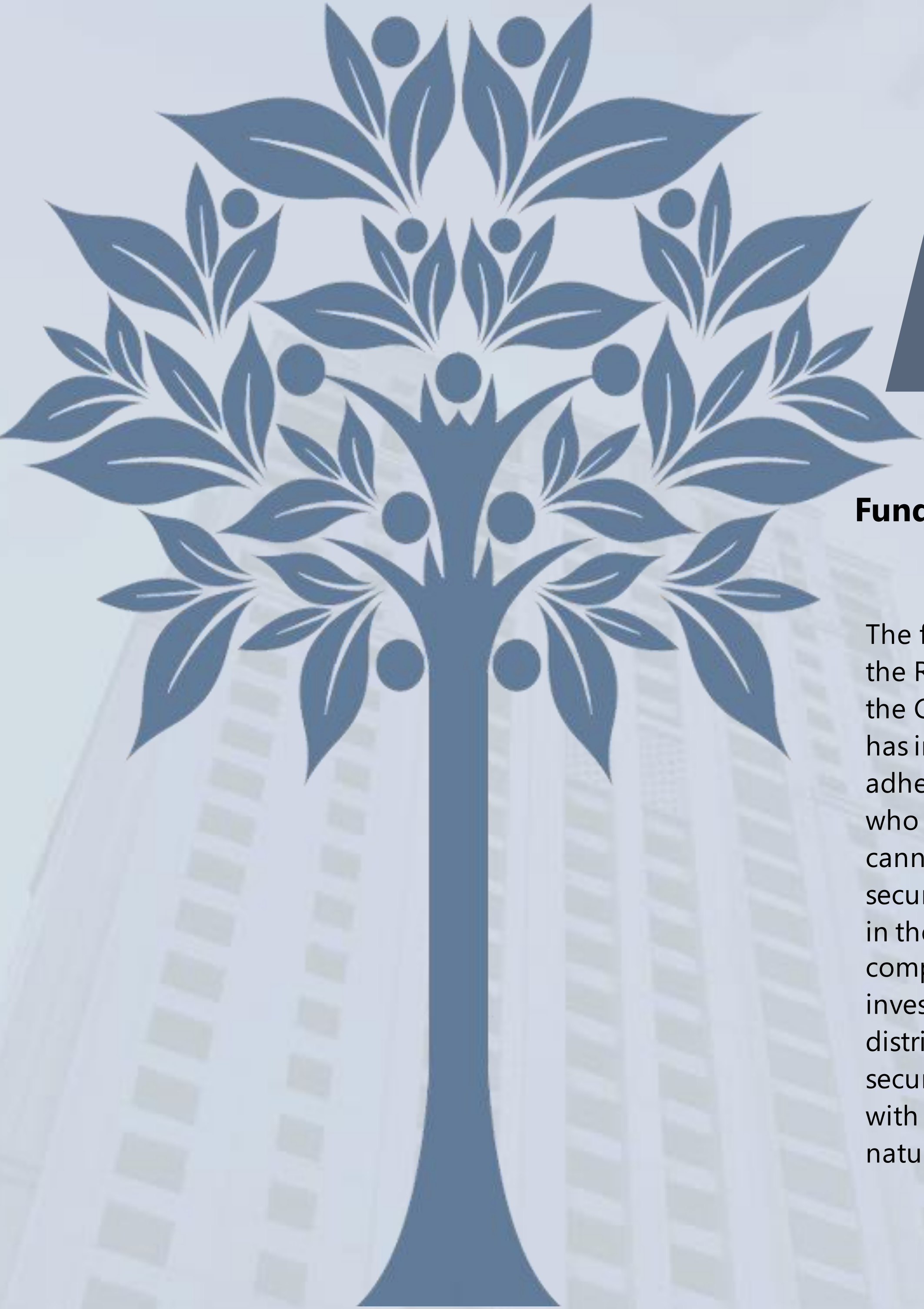

Articles

Fund raising challenges of startups under the Companies Act

By **Noorul Hassan**

The first article in this issue of Corporate Amicus discusses a recent decision of the Registrar of Companies, NCT of Delhi and Haryana relating to Section 42 of the Companies Act, 2013 (private placement of shares). The Adjudicating Officer has in this decision observed that the provision requires that the company should adhere to the limit of 200 persons not just with respect to the number of persons who ultimately subscribe to the securities of the company, but also that this limit cannot be exceeded at the time of making an offer or invitation to offer of the securities of the company. It was also held that the role played by an intermediary in the present case could not be relegated to mere 'generation of interest in the company', instead it was an active facilitator for allowing the companies to raise investments through its portal and provided the services of media/ marketing/ distribution channel/ agent to inform the public at large about the issue of securities. Considering the case, the author opines that the provisions dealing with fund raising by startups could do with a fresh look particularly due to the nature of business and the need for funds.

Fund raising challenges of startups under the Companies Act

By Noorul Hassan

Recently, the Registrar of Companies, NCT of Delhi and Haryana[1], has levied penalty on M/s. Anbronica Technologies Private Limited ('**Company**') and two of its directors for contravening Section 42(7) of the Companies Act, 2013 ('**Act**') *vide* its Order dated 1 March 2023 ('**Order**').

Section 42 of the Act deals with issue of shares on private placement basis. Section 42(7) states that a company shall not while issuing securities release any public advertisements or utilise any media, marketing or distribution channels or agents to inform the public at large about such an issue. Explanation I to Section 42(3) defines the term 'private placement' as any offer or invitation to subscribe or issue of securities to a select group of persons (other than by way of a public offer).

The Order states that the Company had approached M/s. Tyke Technologies Private Limited ('**Tyke**'), which is running a technology-based community platform under the brand name 'Tyke'. It was observed that on its platform, Tyke had created a network of individuals from the business industry, corporate executives and professionals who are part of the Startup ecosystem. These members have access to the content on the platform, thereby Tyke facilitates in knowledge sharing on investing in Startups and organising online pitching sessions. Tyke also facilitates in setting up of an escrow bank account for accepting investment in a separate subscription bank account, verifying the identity of the investors, etc.

The Order records the terms and conditions of using the Tyke platform, which includes a statement that the platform has an internal mechanism to restrict the number of investors that view the detailed profile to 200 by default; and that the information provided through Tyke should not considered as (i) an offer, or solicitation of an offer, to purchase or sell any security, other asset or service, (ii) investment advice or an offer to provide such advice; or (iii) a basis for making any investment decision.

Tyke also confirms that it organises online pitching sessions in the format of an AMA ('Ask Me Anything') for a company seeking investment to interact with community members of Tyke and to collect investment interest. The AMA sessions are accessible by all community members, which are running into 1.5 lakhs currently, and thereafter the recorded sessions are uploaded onto Tyke's YouTube channel.

In the case of the Company, while the Board Approval was received for the issuance of CCDs on 10 July 2021 itself, the Company created a brand name 'DECIWOOD' on Tyke and initiated a campaign for raising funds towards the issue of CCDs

[1] Appointed as Adjudicating Officer under Section 454(1) of the Companies Act, 2013 for adjudicating the penalties under the provisions of the Act.

until 25 July 2021. On receipt of communication of interest to invest, the Company identified 28 members to whom 125,000 Compulsorily Convertible Debentures (CCDs) of INR 10/- each were issued at par. For this purpose, a special resolution was also passed authorising issuance of CCDs on 2 August 2021 and also the PAS – 4 (Private Placement Offer Letter cum application form) was circulated to invite the subscription money from the identified investors, which was received from the identified persons in the virtual Escrow Account to the Company's separate bank account. While that is so, the amount so invested was received into the Escrow Account before the date of the Extraordinary General Meeting (EGM) itself in which the special resolution was passed on 2 August 2021. Further, there was over-subscription for the CCDs, as displayed on the website of Tyke.

As a consideration for the services, Tyke charged 2% plus GST on the amount transferred in the Escrow Account by the community member. The Company has access to the list of community members anytime who have parked their money in their own virtual Escrow Account, which can exceed beyond 200.

Tyke also charged the Company a service fees, which is calculated as a percentage ranging from 1% to 4% of the amount raised from the investors and transferred to the Company's Escrow Account. Noticing all of these facts, the ROC had issued a Show Cause Notice for the violation of the provisions under Section 42 of the Act.

On behalf of the Company, it was argued that the Company has only availed value added services (VAS) provided by the Tyke platform, which are in the form of facilitation of connecting like-minded people community with start-ups, verification of KYC, opening of escrow account, etc. For this purpose, a Service Agreement was executed between the Company and Tyke.

The Adjudicating Officer held that the provision requires that the company should adhere to the limit of 200 persons not just with respect to the number of persons who ultimately subscribe to the securities of the company, but also that this limit cannot be exceeded at the time of making an offer or invitation to offer of the securities of the company.

Considering that community members showing interest in the company can exceed 200 as per Tyke, the AO had concluded that the offer/ invitation had taken place or been made to more than 200 persons. The AO had also noted that based on the role played by Tyke, it cannot be relegated to mere 'generation of interest in the company', instead it is an active facilitator for allowing the companies to raise investments through its portal and is providing the services of media/ marketing/ distribution channel/ agent to inform the public at large about the issue of securities. The AO also noted that Tyke has collected commission at various stages of the campaign from the Company and from the investors.

Concluding remarks

Private limited companies are the favoured entity structures in India due to their wide recognition, limited liability concept and acceptance by the regulators and stakeholders. Startups have been given impetus and privileges so that they can thrive in the competitive market. Undoubtedly, Startups need a special treatment for attracting investments. They cannot be treated on par with other traditional companies. However, companies like Tyke that are running unique platforms for bringing investors and startups together need a special treatment under the Act, without of course, compromising on the quality of information circulated through them and also securing adequate protection.

Thankfully, the Companies Act does not have specific provisions punishing the 'abetment' of offences for contravention of Section 42, and therefore Tyke cannot be held liable for any consequences for abetting the contravention of the provisions of the Act by the Company. However, in this regard, the provisions dealing with fund raising by Startups could do with a fresh look particularly due to the nature of business and the need for funds. Otherwise, there is always a high risk of a liquidity crisis.

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Articles

Digital India Act: Evolving clarity & challenges

By **Sameer Avasarala and Prashant Phillips**

The Digital India Act (DIA) is set to replace the Information Technology Act, 2000 (IT Act) on account of a transformed internet landscape today, with significant internet penetration, multiple intermediaries operating across the internet and complex forms of user harms. The second article in this issue of the newsletter hence discusses the glimpse into the Digital India Act, as presented recently by the Minister of State for Electronics & Information Technology. The authors in this regard discuss how the DIA lays importance on open internet, protection of online safety and trust of internet users, and recognizes that the nature of intermediaries and role played by them have transformed significantly and are functionally different. They also note that while some broad obligations around due diligence, content restrictions, grievance redressal are likely to remain, the new approach may invite certain new requirements linked with definitive penalties for non-compliance, unlike the IT Act. The article concludes by stating that it would be interesting to track incremental developments on the Digital India Act and analyze its impact across various industries.

Digital India Act: Evolving clarity & challenges

By Sameer Avasarala and Prashant Phillips

The Minister of State of Electronics & Information Technology presented a glimpse into the Digital India Act, 2023 ('**DIA**') on March 9 ('**Presentation**'), as part of ongoing consultations[2]. The DIA is set to replace the Information Technology Act, 2000 ('**IT Act**') on account of the transformed internet landscape today, with significant internet penetration, multiple intermediaries operating across the internet and complex forms of user harms. As part of said presentation, many clarifications regarding the nature, scope and extent of DIA were given by the Minister.

Apart from highlighting the need for 'global standard' cyber laws to secure an open, safe and trusted internet, it was also emphasized that such law acts as a catalyst for innovation and growth of the technology and digital ecosystem, for managing complexities of intermediaries, for protecting citizen rights and addressing risks associated with emerging technologies. Considerable importance was also accorded to the importance of a framework that would be future-proof and future-ready.

It was proposed that the comprehensive digital framework would comprise of four pillars: an overarching Digital India Act, which would govern information technology law, a telecommunications law framework, a draft of which was released for public consultations recently i.e., the Draft Indian Telecommunications Bill, 2022[3] ('**Telecom Bill**'); and the proposed personal data protection law, being the Digital Personal Data Protection Bill, 2022[4] ('**DPDP Bill**') which deals with personal data, all of which laws are currently in the draft stage. A separate framework regarding regulation of non-personal data, being the National Data Governance Framework Policy[5] ('**Data Governance Policy**'), was also proposed recently.

Open internet:

The Presentation emphasized on the importance of an open internet which presents choice to consumers, promotes

[2] Presentation on Digital India Act, available at https://www.meity.gov.in/writereaddata/files/DIA_Presentation%2009.03.2023%20Final.pdf

[3] Draft Indian Telecommunication Bill, 2022 available at https://dot.gov.in/sites/default/files/Draft%20Indian%20Telecommunication%20Bill%2C%202022.pdf

[4] Digital Personal Data Protection Bill, 2022, available at https://www.meity.gov.in/writereaddata/files/The%20Digital%20Personal%20Data%20Potection%20Bill%2C%202022_0.pdf

[5] National Data Governance Framework Policy, available at https://www.meity.gov.in/writereaddata/files/National-Data-Governance-Framework-Policy.pdf

competition among digital players, furthers online diversity, facilitates fair market access for start-ups and new entities, and extends ease of doing business and compliance. Some of the key aspects proposed under the open internet objective include:

(a) The DIA would safeguard innovation to enable growth and development of emerging technologies such as artificial intelligence, machine learning, internet-of-things, distributed ledger technology, and other prominent emerging technologies. However, it is unclear if the DIA would include anonymization standards for facilitating generation of training data.

(b) Such framework would also fuel the promotion of digital governance and delivery of public services through online platforms, mobile applications and other digital means alike.

(c) It is likely that the proposed legislation may recognize the role of '*digital gatekeepers*' in the functioning of internet and impact of their actions, for example in creating or limiting entry barriers, creating an ecosystem of services and in establishing a level-playing ground.

Online safety and trust:

The proposed legislation also includes several aspects concerning protection of online safety and trust of internet users. As part of its objectives, the Bill aims to:

(a) Protect users from online harm by introducing offences such as cyber-flashing, offences against protected groups such as women, cyber-bullying, doxing and salami-slicing attacks

(b) Age-gating certain sections of the internet to protect children, such as addictive technologies, platforms collecting children's data, privacy, placing restrictions on targeted advertising (also covered under the DPDP Bill[6]) to protect privacy of children

(c) Extending digital user rights such as the right to be forgotten (which has been excepted from the recent version of the DPDP Bill), right to secured electronic means, right to redressal, right to digital inheritance (ostensibly, an expanded version of the right to nominate[7]), rights against discrimination and rights in respect of automated decision making

(d) Moderation of fake news and other false online content published on social media platforms, websites and other forums

[6] Section 10(3), Digital Personal Data Protection Bill, 2022.

[7] Section 15, Digital Personal Data Protection Bill, 2022.

(e) Regulation of high-risk AI systems through quality testing frameworks, algorithmic accountability, threat and vulnerability assessments, content moderation, etc.

(f) Empowering agencies like Indian Computer Emergency Response Team ('**CERT-IN**') for cyber resilience, issuing advisories on information and data security practices and strengthening penal consequences for non-compliance

(g) Regulation of privacy-invasive devices such as spy cameras, wearable technologies and other hardware (which was also provided in the Report of the Joint Committee[8]); and

(h) Content monetization rules for user-generated and platform-generated content.

It was also proposed to introduce an accountability framework which includes adjudicatory and appellate mechanisms for digital operators, digital contraventions or offences, algorithmic transparency, and periodic risk assessments applicable to certain players.

Revisiting the intermediary framework:

At the outset, it was recognized that the nature of intermediaries and role played by them have transformed significantly and are functionally different. Intermediaries may be conduits (*or technical providers of internet access or transmission services*) or hosts (*which provide content or platform services*) or of any other nature[9]. They may also be classified based on nature and extent of involvement in content transmission, type of work undertaken by them, platform content *vis-à-vis* user generated content, role in peer-to-peer sharing of information etc. This is in stark contrast to the one-size-fits-all approach adopted under the IT Act[10].

It is recognized that different types of intermediaries exist in the digital space today, which is only expected to increase in the future. These may include e-Commerce platforms, search engines, social media platforms, digital media entities, gaming platforms, and pure-play intermediaries such as Telecom Service Providers, Internet Service Providers. There is a need to treat each of them distinctly in terms of the role played by them and introduce a nuanced regulatory approach and separate rules for each class thereof.

Significant questions were also raised as to the suitability of safe harbour for all intermediaries, given that the IT Act

[8] Para 1.15.16, Report of the Joint Committee on Personal Data Protection Bill.

[9] Frequently Asked Questions on Internet Intermediary Liability, Association for Progressive Communications, available at https://www.apc.org/en/pubs/apc%E2%80%99s-frequently-asked-questions-internet-intermed

[10] Section 2(1)(w), Information Technology Act, 2000.

approaches this issue with extending safe harbour to all intermediaries[11]. In contrast, the DIA may witness novelty in approaching intermediary regulation. It was reported[12] that the Minister spoke on the multiple types of participants in the internet ecosystem and the different types of guardrails and regulatory requirements that would have to be developed for each of them.

While some broad obligations around due diligence, content restrictions, and grievance redressal are likely to remain, the new approach may invite certain new requirements linked with definitive penalties for non-compliance, unlike the IT Act in which liability only accrues for third-party content[13].

This may include a proposal to limit safe harbour to certain types of '*pure-play*' intermediaries such as Telecom Service Providers, Internet Service Providers and hosting or cloud providers. However, it is unclear if intermediaries which have a role in content moderation or selectively propagating (sponsored or other) content would be able to take advantage of the safe harbour provisions. This may also have a wide-ranging effect on many intermediaries such as online content platforms, social media, search engines, e-commerce portals and other intermediaries facilitating uploading of sponsored content. Distinction may have to be drawn between platform-generated, user-generated content and further inquiry may have to be made into the (decisional) role that intermediaries may exercise with regard to the latter.

Conclusion:

The DIA has big shoes to fill, as it sets to replace a vital, comprehensive and overarching information technology legislation. The first draft of the DIA is expected to release after the conclusion of stakeholder consultations on the issue[14]. In any case, it would be interesting to track incremental developments on the Digital India Act and analyze its impact across various industries.

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[11] Section 79, Information Technology Act, 2000.

[12] Safe Harbour Clause and Why the Government want it Gone, available at https://www.ndtv.com/india-news/government-may-remove-safe-harbour-provision-in-it-act-2000-what-is-the-clause-3848752

[13] Section 79(1), Information Technology Act, 2000.

[14] Govt to Table Digital India Act in July Post Consultations, available at https://inc42.com/buzz/govt-to-table-digital-india-act-in-july-post-consultations/

Notifications & Circulars

- Filing of Forms GNL-2, MGT-14, PAS-3, SH-8, SH-11 due to migration from V2 version to V3 version in MCA 21 portal from 22 February 2023 to 31 March 2023
- Master Circular for Foreign Venture Capital Investors (FVCIs) issued
- Master Circular for Portfolio Managers issued
- SEBI (Foreign Portfolio Investors) (Amendment) Regulations, 2023 notified
- Operational Guidance – Amendment to SEBI (Buy-back of Securities) Regulations, 2018 issued
- Extension in enforcement of Food Safety and Standards (Advertising and Claims) Second Amendment Regulations, 2022

Filing of Forms GNL-2, MGT-14, PAS-3, SH-8, SH-11 due to migration from V2 version to V3 version in MCA 21 portal from 22 February 2023 to 31 March 2023

Ministry of Corporate Affairs *vide* its General Circular No. 05/2023 dated 22 February 2023 has notified that the companies intending to file (i) Form GNL-2 (filing of prospectus related documents and private placement), (ii) MGT-14 (filing of Resolutions relating to prospectus related documents, private placement), (iii) PAS-3 (Allotment of Shares), (iv) SH-8 (letter of offer for buyback of own shares or other securities), (v) SH-9 (Declaration of Solvency) and (vi) SH-11 (Returns in respect of buy-back of securities) from 22 February 2023 to 31 March 2023 on the MCA-21 Portal may file such Forms in physical mode duly signed by the persons concerned as per requirements of the relevant forms, along with a copy thereof in electronic media, with the concerned Registrar, without payment of fee, and take acknowledgement (as per Annexure to the Circular) thereof. Such filing will be accompanied by an undertaking from the company that, the company shall also file the relevant Form in electronic form on MCA-21 Portal along with fee payable as per Companies (Registration Offices and Fees) Rules, 2014. General Circular Number 04/2023 dated 21 February 2023 has also clarified that no additional fees will be levied.

Master Circular for Foreign Venture Capital Investors (FVCIs) issued

Securities and Exchange Board of India ('**SEBI**') *vide* SEBI/HO/AFD/PoD/P/CIR/2023/34 dated 3 March 2023 has issued Master Circular for Foreign Venture Capital Investors. Pursuant to this Master Circular, following three SEBI Circulars have been rescinded: (i) SEBI Circular No. IMD/DOF-1/FVCI/CIR.No.1/2009 dated 3 July 2009; (ii) SEBI Circular No. SEBI/IMD/DOF-1/FVCI/CIR-1/2010 dated 12 January 2010; and (iii) SEBI Circular No. SEBI/HO/IMD/DF1/CIR/P/2017/75 dated 6 July 2017. However, any applications, approval, actions, etc. pending under the rescinded circulars shall be deemed to be made under this Master Circular. Further, any investigation, penalty, etc. shall remain unaffected as if the rescinded circulars have never been rescinded.

The Master Circular deals with (i) Firm commitment requirement from the investors for registration as a Foreign Venture Capital Investor (FVCI) for contribution of an amount of at least USD 1 million at the time of submitting the application; (ii) Quarterly reporting in a new format as released by this Master Circular; and (iii) Mandatory Online filing system for FVCIs which can be used for application for registration, reporting and filing under the provisions of FVCI Regulations.

Master Circular for Portfolio Managers issued

SEBI *vide* SEBI/HO/IMD/IMD-POD-1/P/CIR/2023/38 dated 20 March 2023 has issued Master Circular for Portfolio Managers. Various circulars issued by SEBI with respect to Portfolio Managers till 30 November 2022 have been incorporated in this

Master Circular. A total of 32 circulars (as mentioned under Annexure Z of the Master Circular) have been rescinded. However, any applications, approval, actions, etc. pending under the rescinded circulars shall be deemed to be made under this Master Circular. Further, any investigation, penalty, etc. shall remain unaffected as if the rescinded circulars have never been rescinded.

This Master Circular, at one place, deals with (i) Registration and Post-Registration Activity as a Portfolio Manager, wherein application procedures, guidelines, etc. is stated; (ii) Operating Guidelines for advertisements by portfolio managers, maintenance of clients' funds, etc.; (iii) Investments by portfolio managers in Corporate Bonds, derivatives; minimum credit rating of securities for investments, etc.; (iv) Disclosure requirements such as material change in disclosure document, fees & charges, related party investments by portfolio managers; (v) reporting requirements; (vi) fees and charges; and (vii) grievance redressal.

SEBI (Foreign Portfolio Investors) (Amendment) Regulations, 2023 notified

SEBI *vide* its notification dated 15 March 2023 has notified SEBI (Foreign Portfolio Investors) (Amendment) Regulations, 2023. Pursuant to this amendment, (i) Regulation 3(2) of the SEBI (Foreign Portfolio Investors) Regulation, 2019 has been amended to broaden the scope of fee. In addition to the fee specified in Part A of the Second Schedule for registration as foreign portfolio investor, the Board may charge fees on the basis of any other document as to be specified from time to time; (ii) Regulation 22(1)(b) is amended to include that any false or misleading information submitted previously to the Board or designated depository participant shall be intimated to SEBI not later than 7 working days of such submission. Similar amendment in Regulation 22(1)(c) and (e) has also been notified; (iii) Regulation 22(5) has been amended to include that in case of any change in structure or ownership of foreign portfolio investor, notice of the same in not later than 7 working days shall be made; and (iv) Regulation 31(1)(b), (c) and (g) is amended to include that any false or misleading information; change in information; and any penalty or pending litigation must be notified to the Board by all designated depository participants who have been granted approval by the Board.

Operational Guidance – Amendment to SEBI (Buy-back of Securities) Regulations, 2018 issued

SEBI *vide* SEBI/HO/CFD/PoD-2/P/CIR/2023/35 dated 9 March 2023 has issued Operational Guidance to Buy-Back Regulations. SEBI has notified SEBI (Buy-Back of Securities) (Amendment) Regulations, 2023 on 7 February 2023 to be effective from 9 March 2023. This regulation shall be made effective for all buy-back offers where the Board of Directors of the company approve resolution with respect to Buy-back on or after 9 March 2023. Pursuant to this operational guideline:

(A) Restrictions has been set out under Regulation 16(vi) of Buy-back Regulations for the companies undertaking buy-back through stock exchange route, which are: (i) The company shall not purchase more than 25% of the average daily trading volume (in value) of its shares or other specified securities in the ten trading days preceding the day in which such purchases are made; (ii) The company shall not place bids in the pre-open market, first thirty minutes and the last thirty minutes of the regular trading session; and (iii) The company's purchase order price should be within the range of ±1% from the last traded price;

(B) Margin Requirement for deposits in Escrow Account - The portion of escrow account in the form of other than the cash shall be subject to appropriate haircut, in accordance with the SEBI Master Circular for Stock Exchange and Clearing Corporations dated 5 July 2021. Further, the Merchant Banker to buy-back offer is advised to ensure that the adequate amount after the applicable haircut is available in escrow account till the completion of all formalities of buyback.

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Extension in enforcement of Food Safety and Standards (Advertising and Claims) Second Amendment Regulations, 2022

Food Safety and Standards Authority of India ('**FSSAI**') *vide* its Direction dated 27 February 2023 has provided for extension of enforcement of Regulation 4(7) of the Food safety and Standards (Advertising and Claims) Second Amendment Regulations, 2022 for a period of six months from the date of notification, i.e. from 13 December 2022.

Such extension is because Regulation 4(7) of FSS (Advertising and Claims) Regulation 2018 & re-operationalization of FSS (Advertising and Claims) Regulation 2021 specifies that in case of trademark, brand name or fancy name containing adjectives such as 'natural',' fresh',' pure etc., a disclaimer that '*This is only brand name or trademark and does not represent its true nature*' shall be mentioned below such trademark, brand name or fancy name. However, the final FSS (Advertising and Claims) (Second Amendment) Regulations, 2022 directs a slight change in the disclaimer, which is: '*This is only brand name or trademark, **or fancy name** and does not represent its true nature **(relevant one may be chosen as applicable)***' shall be mentioned prominently on the front of pack of the label.

Lakshmikumaran & Sridharan attorneys

Ratio Decidendi

- Dissenting secured creditors cannot be treated higher than other creditors under Section 53 of the Insolvency and Bankruptcy Code, 2016 just because they enjoy security interest – NCLT, Kolkata
- Insolvency – When Financial Creditors are not paid in full in the Resolution Plan, Operational Creditors cannot claim a higher amount – NCLT Ahmedabad
- Arbitration under Section 42 of the Special Economic Zones Act, 2005 shall override any contractual agreement between the parties – Telangana High Court

Dissenting secured creditors cannot be treated higher than other creditors under Section 53 of the Insolvency and Bankruptcy Code, 2016 just because they enjoy security interest

The National Company Law Tribunal ('**NCLT**'), Kolkata Bench while hearing an application under Section 60(5) of the Insolvency and Bankruptcy Code, 2016 ('**IBC**') has held that merely because a creditor enjoys security interest, it cannot be treated higher than other creditors who have financed the corporate debtor.

Brief facts

In the present case, the Applicant was a secured financial creditor of the Corporate Debtor. Corporate Insolvency Resolution Process ('**CIRP**') was initiated against the Corporate Debtor and the Applicant submitted its claim which was admitted by the resolution professional (RP). During the process, along with the claim, it was submitted by the Applicant that it was the first charge holder of certain immovable properties of the Corporate Debtor against the loan availed by it and thus should be given preference in repayment over other creditors. It was submitted that, inspite of the same, the Applicant was being treated on par with the other creditors due to the calculation methodology opted by the RP. Thereafter, the Applicant dissented to the resolution plan approved by the Committee of Creditors ('**CoC**'), which was not taken into consideration. Accordingly, the present application has been filed seeking for rejection of the Resolution Plan.

Submissions by the Applicant:

- It was submitted by the Applicant that there were no provisions under the IBC to rescind the security interest on a property during insolvency resolution process and so, the provisions under the Transfer of Property Act, 1882 wherein it is said that the right of the first charge holder of a property shall prevail over the others should be applicable in such a case.
- It was also submitted that the resolution plan was prejudicial to its interests as the Applicant would receive far lesser value of proceeds than otherwise entitled to due to their treatment being at par with other creditors. It further submitted that there would be no benefit for them to be a part of such resolution where the priority of a secured creditor having first charge as its security interest is ignored and they are treated the same as the unsecured/other creditors.

Submissions by the Respondent:

- It was submitted that the resolution plan was approved by 78.79% of the CoC in all its wisdom, with the Applicant being the dissenting financial creditor. Hence, the Plan cannot be interfered with.
- It was also submitted that, as per Regulation 37(1)(d) of the CIRP Regulations, 2016, a resolution plan can include

satisfaction or modification of any security interest. Therefore, in the present case, the Applicant's security interest can be dealt with in the resolution plan approved by the CoC and it has been done that way.

- It was further submitted that the Applicant is being paid a sum of money according to Section 30(2)(b) of IBC that stipulates a minimum amount of the liquidation value receivable by a dissenting secured financial creditor under Section 53(1) of the IBC. Therefore, the claim by the Applicant that the computation methodology shall be as per Section 52(1)(b) of IBC, and further subsections of Section 52 of IBC, is flawed for the purpose of determining entitlement of a dissenting financial creditor under Section 30(2)(b) of IBC.
- The Respondent placed reliance on the judgment of *India Resurgence ARC Private* v. *Amit Metaliks Limited and Another*, 2021 SCC Online SC 409, wherein it was held that the amount to be paid to different classes of creditors is a decision to be taken according to the commercial wisdom of the CoC and no creditor can claim higher amounts with reference to the security interest held by it.

Decision:

The NCLT placed reliance on the judgment by the Hon'ble Supreme Court in *Amit Metaliks Limited (supra)* and held that a creditor shall not be treated as higher than other creditors having financed the corporate debtor merely because he holds security interest over the corporate debtor's movable/immovable property. It further observed that if such dissenting secured creditors are given preference over other creditors, then every secured creditor would dissent to the resolution plan and the same would lead to more liquidations rather than resolutions which would not lead to the maximization of the value for the corporate debtor and the purpose of the CIRP would fail. Therefore, the NCLT refrained from interfering in the commercial wisdom of the CoC and rejected the Applicant's application.

[*ICICI Bank Limited* v. *Pratim Bayal (Resolution Professional) & Anr., in matter of Trimurti Associates Private Limited* v. *BKM Industries Limited* – Judgment dated 1 March 2023 IA. (IB) No. 471/KB/2022 In C.P. (IB) No. 2078/KB/2019, NCLT]

Insolvency – When Financial Creditors are not paid in full in the Resolution Plan, Operational Creditors cannot claim a higher amount

The National Company Law Tribunal ('**NCLT**'), Ahmedabad Bench has held that when Financial Creditors have not been paid in full in the Resolution Plan, the Operational Creditors cannot claim a higher amount under the same.

Brief facts:

The Corporate Debtor was admitted into Corporate Insolvency Resolution Process ('**CIRP**'). Thereafter, the Successful Resolution Applicant submitted a Resolution Plan, which was approved by the Committee of Creditors ('**CoC**') with 99.732% votes. The Resolution Plan proposed to pay INR 365.85 crore to the secured Financial Creditors as against an admitted claim of INR 1696.82 crore. The Operational Creditors were proposed to be paid INR 19 lakh as against an admitted claim of INR 114.7 crore. The Petitioner, being one of the Operational Creditors of the Corporate Debtor, filed the present application seeking rejection of the Resolution Plan.

Submissions by the Applicant:

- It was submitted that the Resolution Plan undermines the interest of the Operational Creditors. The Operational Creditors are being paid a meagre amount of 0.096% of their total claim, while the Financial Creditors are being paid 21.56% of their claims in the resolution plan.
- It was submitted that, as per the provisions of the Code and the Regulations made thereunder, a Resolution Plan must fulfill the following criteria for it to be viable: (a) The Resolution Plan must be fair and equitable in terms of settlement of claims of the Operational Creditors *vis-a-vis* the Financial Creditor; (b) The Resolution Applicant must provide for performance security in accordance with Regulation 36B(4A) of the Insolvency and Bankruptcy Board of India (Insolvency of Corporate Persons) Regulations, 2016 ("**Regulations**") and the same should be sufficient to ensure the performance of obligations by the Resolution Applicant according to the approved plan; and (c) The Resolution Professional is obligated to submit evidence of receipt of performance security (as required under Regulations 36B (4A) of the Regulations along with the certificate in Form H of the Schedule. It was submitted that said criteria was not satisfied in the present case.

Submissions by the Respondent:

- It was submitted that, in the Resolution Plan, Financial Creditors are being paid INR 365.85 crore as against the claim of INR 1696.82 crore, i.e only 21.56% of the admitted claim and on the other hand, Operational Creditors are being paid INR 0.19 crore (stated in the pleadings) as against the admitted claim of INR 114.7 crore, which comes to 0.096% of the admitted claim. Accordingly, there is no necessity for allocation of further funds, as per Section 30(2) of the IBC.
- It was submitted that performance security of INR 10 Crore was duly deposited in the account of Corporate Debtor as recorded in the Resolution Plan, and thus there is compliance with Regulation 39(4) of the Regulations.

Decision:

The Supreme Court has relied on the case of *Vallal RCK* v. *Siva Industries and Holdings Limited and Ors*. to hold that the commercial wisdom of the CoC has to be given paramount status without any judicial intervention for ensuring completion of the stated processes within the timelines prescribed by the IBC. In the present case, since the Resolution Plan has been approved by the CoC with 99.732% voting in its favour, the same has to be proceeded with. The Bench observed that a conjoint reading of Section 30 and Section 53 of IBC shows that the Financial Creditors are placed at a higher priority than Operational Creditors. The Secured Financial Creditors are covered by Section 53(1)(b)(ii) and the Unsecured Financial Creditors are covered by Section 53(1)(d). The Operational

Creditors are to be considered thereafter, having lower priority, and are covered by Section 53(1)(f). It was concluded that since the Financial Creditors have not been paid in full, the Operational Creditors cannot claim a higher amount. It was observed that the requirements of performance guarantee, its sufficiency and receipt before approval of the Resolution plan are also subject to the commercial wisdom of the CoC.

[*Noble Resource International Pvt. Ltd.* v. *Sona Alloys Pvt. Ltd.*, – Order dated 6 February 2023 in IA No.431 of 2021 In CP(IB) No.586 of 2019, NCLT Ahmedabad Bench]

Arbitration under Section 42 of the Special Economic Zones Act, 2005 shall override any contractual agreement between the parties

The High Court of Telangana has held that section 42 of the Special Economic Zones Act, 2005 ("**SEZ Act**"), which provides for dispute resolution between an 'Entrepreneur' and a 'Developer'/ or a developer and developer, or an entrepreneur and entrepreneur through arbitration by a tribunal appointed by the Central Government, has an overriding affect over Section 11 of the Arbitration and Conciliation Act, 1996 ("**Arbitration Act**"). The Court held that even if the arbitration contract executed between the parties consists of any details regarding the way in which the arbitrator is supposed to be appointed, Section 42 of the SEZ Act shall prevail.

Brief facts:

In the present case, the Petitioners were the owners and developers of their lands. The Respondents approached the Petitioners with the proposal to build their business units on their land and also on the adjacent lands, thus proposing to become co-developers of the land. The Petitioners agreed to the same and they entered into a co-development agreement amongst themselves; they decided on a share of 1:3 on the total area of land. These lands were in the Special Economic Zone. The Respondents decided to increase their area of development. Therefore, they took requisite permissions from the concerned SEZ authorities. However, no information of the expansion was provided to the Petitioners, leading to disputes between the parties. Therefore, the Applicants invoked the arbitration agreement between the parties, as per which a three-person arbitral tribunal is to be constituted. On failure to reach consensus on the third arbitrator, the Petitioners filed the present application under Section 11 of the Arbitration Act.

Submissions by the Petitioners:

- It was submitted that the scope under Section 11 of the Act is limited to the examination of a pre-existing arbitration agreement, which exists in the present case. Further, the Respondents themselves have submitted themselves to arbitration by nominating an arbitrator. Accordingly, on failure to reach consensus, the High Court can only appoint an arbitrator u/s. 11 of the Arbitration Act.
- It was submitted that the subject property in question falls under Section 2(zn) of the Real Estate (Regulation and Development) Act, 2016 and not under the Special Economic Zones Act, 2005.

Lakshmikumaran & Sridharan attorneys

Submissions by Respondents:

- It was submitted that theproperty in question is a part of the SEZ and therefore the arbitral mechanism that is given under the SEZ Act must be applied. Accordingly, the Central Government should be approached for appointment of an arbitral tribunal.
- It was submitted that the definition of a "developer" under 2(g) of the SEZ Act also includes "co-developer". Accordingly, the dispute raised by the Petitioners in the present scenario being nothing but a civil dispute is hit by Section 23 of the SEZ Act, as per which all disputes are to be referred to a Designated Court constituted under said Act. As per Section 42 of the SEZ Act, if there is no such Designated Court, such dispute **shall** be referred to arbitration and the arbitrator in such arbitration is to be appointed by the central government.
- It was submitted that Section 42 and 51 of the SEZ Act (which says the Act has an overriding effect) start with a non obstante clause, thereby showing the Act's overriding effect over the Arbitration and Conciliation Act.

Decision:

The Courtobserved that the Ministry of Commerce and Industry, Department of Commerce, through their notice published in the Gazette, have clearly claimed that the present property in question is within anSEZ, as has been defined in the Section 3(8) of the SEZ Act. Therefore, it was held that any arbitration relating to the property should be conducted in accordance with Sections 42 and 51 of the SEZ Act. The Court further elucidated that Section 51 of the SEZ Act gives the Act an overriding effect over any other act. Therefore, the present Act has been held to override the Arbitration Act. The Court in this judgment further referred to the case of *National Highway Authority of India* v. *Sayadabad Tea Company*; and *MP power Trading Company Limited* v. *Narmada Equipments* and *Shilpi Industries* v. *Kerala State Road Transport*, wherein it was held that when there is already a special legislation which provides for a certain mechanism to handle any particular situation that arises under such regulations, then that should be followed even if any contract was present between the parties regarding the same.

[*Ranganath Properties Pvt. Ltd. Rep. by its Director & Ors.* v. *Phoenix Tech Zone Pvt. Ltd. Rep. by its Managing Director & Ors.*, Judgment dated 2 March 2023, Arbitration Application No. 72 of 2022, Telangana High Court]

News Nuggets

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Negotiable instruments – Person authorized by the company to sign a cheque is not the 'drawer'

The Bombay High Court has held that the signatory of a cheque, authorized by a company, is not the 'drawer' and that such signatory cannot be directed to pay interim compensation in terms of Section 143A of the Negotiable Instruments Act, 1881 ('**NI Act**'), leaving aside the company. According to the concerned provisions under the NI Act, the 'drawer' of the cheque is deemed to have committed an offence under the Act when the cheque drawn by him is returned unpaid on the specified grounds, subject to fulfilment of certain conditions precedent and subsequent. The Complainant in *Lyka Labs Limited* v. *State of Maharashtra* [Judgment dated 8 March 2023] had contended that the authorized signatory of a company becomes the 'drawer' for the purpose of Sections 138 and 143A of the NI Act as he has been authorized to do so in respect of the account maintained by the company.

Interpretating in plain language (and rejecting the rule of purposive construction) the provisions of Sections 143A and 148 of the NI Act, the Court was of the view that there is no need to interpret the word 'drawer' to include the authorized signatory. It noted that the expression 'drawer' has obtained a fixed and legal connotation over the years on account of (i) the legislature never having changed said definition nor the context in which the expression is used, and (ii) the judicial pronouncements consistently holding drawer to include only the principal offender and not those who are vicariously liable. It noted that the Directors of a company serve as an agent and hence are not liable personally for the acts and actions of the company unless they act beyond their powers and duties. Lastly, the High Court also held that in an appeal under Section 148 of NI Act filed by persons other than the 'drawer' against conviction under Section 138 of the NI Act, a deposit of a minimum sum of 20% of the fine or compensation is not necessary. It was however held that such power to direct deposit of compensation is available with the Appellate Court while suspending the sentence under Section 389 of Code of Criminal Procedure, in a case of appeal by person other than 'drawer'.

Arbitration – Assignee of an agreement is entitled to invoke arbitration clause of the agreement not signed by it

In a case involving assignment of rental payment, the Bombay High Court has held that when the assignee has stepped into the shoes of the assignor and has undertaken to enjoy, exercise and enforce all rights, discretions and remedies available to the assignor, as assigned to it including the rights in respect of repayment of lease rental, even the arbitration clause in the Master Rent Agreement stands extended/assigned to the 'assignee'. The Court in *Siemens Factoring Pvt. Ltd.* v. *Future Enterprises Pvt. Ltd.* [Judgment dated 1 March 2023] observed that if the rights of assignor are specifically assigned in favour of the Applicant-assignee and it had undertaken to discharge all its liabilities and enjoy all its privileges and entitlement, there is no reason why the arbitration clause which permits the parties to refer the disputes for arbitration, arising out of the Master Rental Agreement cannot be invoked by the Applicant-assignee. The Court held that the arbitration agreement is definitely assignable, just as any other contract. It observed that merely because the subsequent communication intimating the assignment to the other party-respondent was not signed, which also comprised of an arbitration clause, it would not preclude the Applicant from invoking arbitration.

Arbitration – Merely because borrower is a MSME, there is no privilege to be bound by arbitral mechanism provided under MSMED Act

The Gujarat High Court has held that merely because the borrower is a registered micro or a small enterprises in terms of the Micro, Small and Medium Enterprises Development Act, 2006 ('**MSMED Act**'), it would not be given the privilege to be bound by the arbitration mechanism under said Act. In this case, Indian Bank had issued a term loan in the favour of Respondent No. 2, which said Respondent had failed to repay and the account wa declared as NPA. Post the same, a notice was issued under Section 13(4) of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002, by Indian Bank for symbolic possession of the property mortgaged to the bank. Thereafter, Respondent No. 2 approached a sole arbitrator unilaterally appointed by it, on the assumption that by virtue of Section 15, 16 and 17 of the MSMED Act, since it was a registered enterprise under the Act, there was an automatic arbitration agreement between the parties and disputes could be referred to <u>any</u> arbitrator. Based on the same understanding, the Sole Arbitrator, being Respondent No. 1, adjudicated the dispute and passed an award in favour of Respondent No. 2. The High Court, on appeal, in the case of *Indian Bank* v. *Morris Samual Christian & Anr.* [Judgment dated 14 February 2023] held that even though the borrower was an MSME enterprise, respective provisions i.e., Section 15, 16, 17 only apply to disputes between the buyer and the supplier of goods and services and said sections does not cover the present circumstances. The court further stated that since there is already a mechanism available under the SARFAESI Act i.e., Section 17(1) to challenge a notice given under Section 13(4) in cases where the borrower is aggrieved by any action taken under this section. Accordingly, it was held that the Respondent cannot resort to arbitration. It was observed that, in any case, the Sole Arbitrator was unilaterally appointed between the parties without relying on any arbitration agreement and/ or approaching the High Court u/s. 11 o the Arbitration and Conciliation Act, 1996 seeking appointment. Accordingly, the appointment was null and void for this reason as well. The Court set aside the award given by the self-appointed arbitrator.

Insolvency – Applications under Sections 7 and 9 are not 'suit' – Restrictions under Section 69(2) of Partnership Act are not applicable

The National Company Appellate Tribunal (NCLAT) has upheld the plea that Section 69(2) of Partnership Act, 1932 ('**Act'**), which bars a suit by an unregistered partnership, is not attracted where an application under Section 9 of the Insolvency and Bankruptcy Code is filed, since Section 9 application is not a 'suit'. The Appellate Tribunal in *Rourkela Steel Syndicate* v. *Metistech Fabricators Pvt. Ltd.* [Judgment dated 6 February 2023] was of the view that the analogy of the

Supreme Court judgment in the decision of *Gaurav Hargovindbhai Dave* v. *Asset Reconstruction Company (India) Limited*, relating to provision of Limitation Act, 1963, being that the limitation as applicable to "any other application for which no period of limitation is provided elsewhere" under Article 137 of the Limitation Act is applicable to the application under Section 7 of IBC which is hence not a "suit", was fully applicable to the application filed under Section 9 IBC also. In this regard, it also noted that according to another Supreme Court decision in the case of *B.K. Educational Services (P) Ltd.* v. *Parag Gupta and Associates*, provision of Section 5 of the Limitation Act, which deals with limitation period for "any appeal or any application, other than an application made under the provisions of O. 21 of the CPC (suits)" is also fully applicable in Section 7 and 9 applications, and as Section 5 of Limitation Act is not applicable to a "suit", it is a clear indication that applications under Section 7 and 9 are not suits.

Insolvency – Right of homebuyers to raise claim before Resolution Professional would not cease to exist when Resolution Plan is still pending adjudication

The NCLT, Mumbai Bench, has held that all claims which do not form a part of the resolution plan will be extinguished only when the resolution plan has been approved by the adjudicating authority. In the present case, the applicants had decided to purchase a flat developed by the corporate debtor. The corporate debtor did not hand over the flat on time and process was delayed. Meanwhile, the applicants came to know about the initiation of Corporate Insolvency Resolution Process (CIRP), and therefore, the applicants had filed their claims before the resolution professional (RP). However the same was rejected by the RP, the reason being that Resolution Plan has already been approved by the members of the Committee of Creditors ('**CoC**') of the Corporate Debtor and the same has been presented before the NCLT for approval. The NCLT in the case of *Dr Shankar Sawant and Anr* v. *Mr Arun Kapoor* [Order dated 3 March 2023] observed that as periodic payments have been successfully made by the flat owners and since the Resolution Plan is still pending adjudication, the right of the homebuyers to raise their claim before the RP would not cease to exist and the Respondent RP is not justified in rejecting the claim of the applicants who are homebuyers in the project constructed by the corporate debtor on the ground of filing of claims belatedly. The NCLT accepted the delay in filing of the claims by the applicants and directed the resolution professional to admit the claims.

Insolvency – Moratorium – Explanation to 14(1)(d) of IBC does not include within its ambit lease premium and lease rent amount

The National Company Law Appellate Tribunal ('**NCLAT**') Principal Bench, New Delhi, has held that the Explanation of Section 14(1)(d) of the Insolvency and Bankruptcy Code 2016 ('**IBC**') does not include within its scope lease premium and lease rent amount. The Respondent had requested the Resolution Professional ('**RP**') to pay the lease premium that was due to it during the moratorium period, and also the lease rent. When the rent was not paid for a period of 15 days, the

Respondent approached the adjudicating authority seeking the authority to direct the RP to make the payment of the due amount or include the same in the CIRP cost of the corporate debtor. The NCLAT in the case of *Sunil Kumar Agarwal* v. *New Okhla Industrial Development Authority* [Judgment dated 12 January 2023] observed that under Section 14(1)(d) of IBC recovery of any property is prohibited during the moratorium period of the corporate debtor, however, according to a bare reading of this section, it would not include lease premium or lease rent that is due to the Respondent.

Insolvency – Petition under Section 9 of IBC can be filed only after expiry of 10 days period under Section 8(2)

The NCLT, Mumbai Bench, has held that the petition under Section 9 of the IBC can only be filed after the expiry of the period of 10 days from the date of the receipt of the demand notice as prescribed under Section 8(2). In this case, the operational creditor had submitted a demand notice to the corporate debtor requesting for payments of the outstanding amount. The operational creditor, without even mentioning the date of default and in the absence of the documents mentioned in the index to the notice in the actual copy received, proceeded with filing of the petition immediately after. The Bench in the case of *Aypols Polymers Private Limited* v. *Suvarna Fibrotech Pvt. Ltd.* [Judgment dated 3 March 2023] held that the operational creditor must wait for a period of ten days as stipulated in Section 8(2) of the IBC. Noting that in the present case the operational creditor had filed the petition on the very next day of serving the demand notice, the NCLT held that the petition was not in accordance with Section 9(1) of the IBC and hence liable to be dismissed.

Insolvency – Defences with respect to pre-existing dispute or no amount due can be raised in direct manner when replying to Section 9 Application

The National Company Law Appellate Tribunal (‘**NCLAT**’) Principal Bench, New Delhi, has held that the IBC does not discourage the corporate debtor from establishing defences pertaining to ‘Pre-existing dispute’ or ‘no amount due’ through reply/ counter filed to the application under Section 9of the Code, and submit supporting documents before the NCLT, even if they failed to respond to the demand notice issued prior to the proceedings under Section 8 of the Code within the prescribed time of 10 days for receiving such notice. The NCLAT in the case of *Greymatter Entertainment Pvt. Ltd.* v. *Pro Sportify Pvt. Ltd.* [Order dated 9 February 2023] held that neither Section 8 nor Section 9 of the IBC indicate that in the event a reply to the demand notice is not filed within 10 days, the corporate debtor is precluded from raising the question of dispute or pleading that there was no amount ‘due and payable’, and that the corporate debtor is not prevented from establishing by way of a reply filed to the Section 9 application and relevant documents, any ‘Pre-Existing Dispute’ or paid ‘Operational Debt’.

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