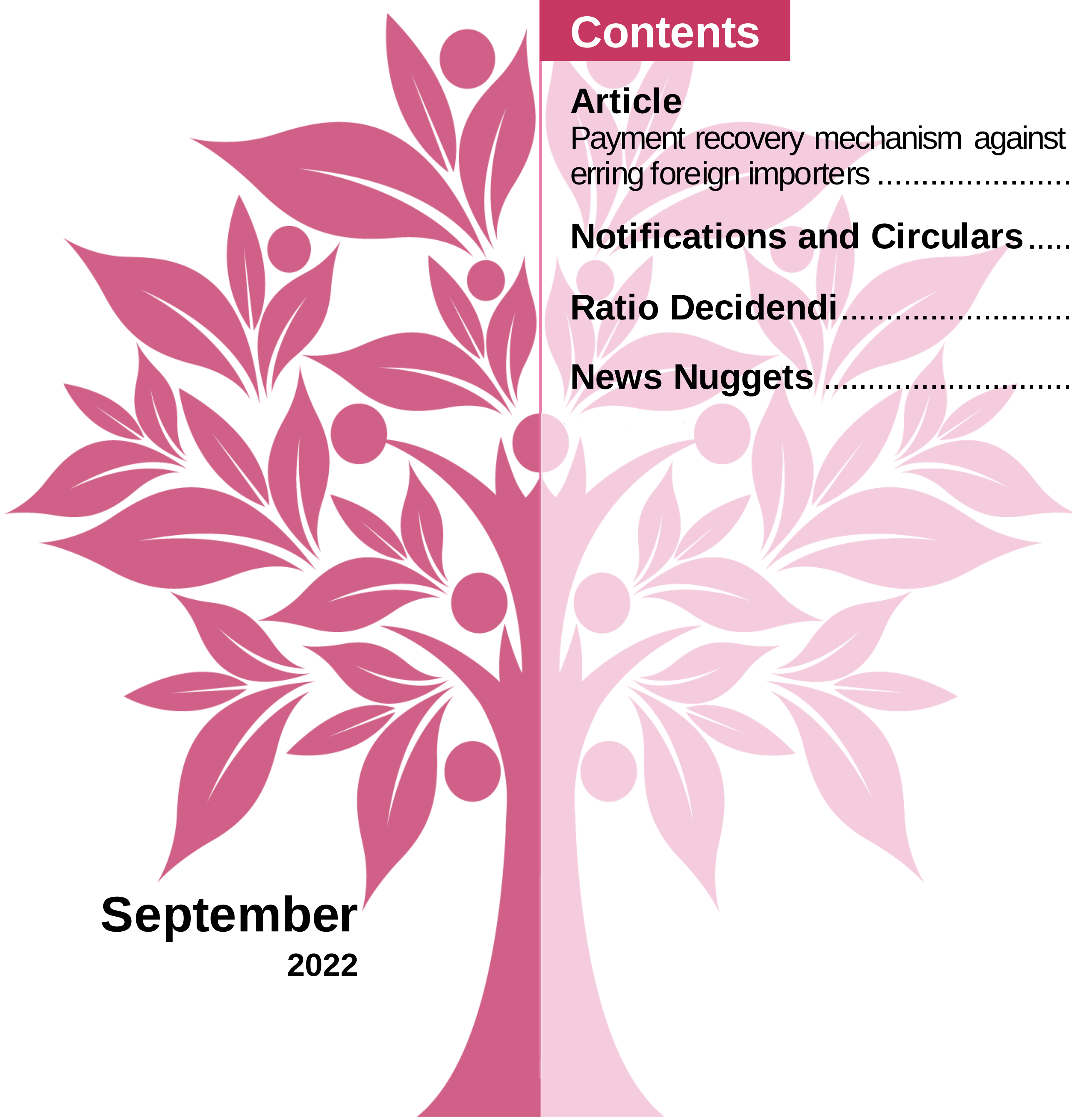
Lakshmikumaran & Sridharan attorneys

corporate

amicus

An e-newsletter from
Lakshmikumaran & Sridharan, India

September 2022 / Issue–132



Contents

September
2022

Article

Payment recovery mechanism against erring foreign importers

By **Aman Gupta**

Since 1991, the opening of Indian markets during the liberalization, privatization and globalization drive in India led to a boost in international/ foreign trade. However, as is said, every coin has a flip side. With increasing globalization and international trade, the risk of non-payment/ non-realization against the exports made to the foreign importers has increased accordingly.

If analyzed from the angle of Foreign Exchange Management Act, 1999 ('**FEMA**'), the obligation to secure payment against their respective exports is primarily on the exporter. The law demands that the exporters shall remain cautious, as even mere inaction from the part of exporter towards realization of export payments beyond the specified period is deemed as a contravention under FEMA. Therefore, risk mitigation with respect to the payment against exports has become a challenge for exporters.

On that note, *firstly*, this article focuses on the exporters' obligations upon non-realization of export payments from erring foreign importers, and the legal and other remedies available with the exporters where the export transactions are not secured in any manner. *Secondly,* since the non-realization/ repatriation of export proceeds are considered a contravention, the options under the FEMA laws with respect to the same.

Exporters' obligation:

The exporters' obligations stem from Foreign Exchange Management (Export of Goods and Services) Regulations, 2015 ('**FEMA Regulations**') and Master Directions on Export of Goods and Services ('**Export Master Direction**') issued thereunder.

As per Regulation 9 of the FEMA Regulations, the exporter is under an obligation to realize the export value within the stipulated period i.e., nine months from the date of export, or fifteen months in case where goods are exported to a warehouse established outside India. Otherwise, the exporters are deemed to be in contravention under the FEMA laws. The law expects from the exporters to take all reasonable steps to realize the payment from the foreign importers in due time.

Legal remedies upon non-realization of export proceeds:

A. *Civil remedies-*

Any non-payment against the goods supplied by the exporter to a foreign importer is an offence under Section 55 of the Sales of Goods Act, 1930 and such exporters are entitled to civil remedies available under the laws of India. The exporters can initiate recovery proceedings by filing a money suit before the jurisdictional civil court under the provisions of the Code of Civil Procedure, 1908 ('**CPC**'). Initiating a civil proceeding against an importer / foreign entity within the territory of India as per Indian laws is permissible under CPC, unless it is against a 'foreign state' for which special prior permission must be obtained by the central government in accordance with Section 86 of the CPC.

B. Remedy through Alternative Dispute Resolution Mechanism-

Alternative Dispute Resolution Mechanism includes arbitration (domestic and international commercial arbitration), mediation, and/ or conciliation, through which parties can settle their disputes including disputes related to foreign trade. However, the requirement such as an existing arbitration agreement between the parties as per Section 7 of the Arbitration and Conciliation Act, 1996 ('**Arbitration Act**'), a written invitation to conciliate as per Section 62 of said Act etc. must be fulfilled for the same. Before initiating any civil proceedings in terms of the abovementioned point, it is necessary to check if the agreement entered into between the parties, if any, or the respective purchase orders in place for carrying out trade transactions indicates or contains the provision for an alternate dispute resolution mechanism. If yes, then the parties should proceed in accordance with the same.

C. Remedy through Directorate General for Foreign Trade-

The non-payment or non-realization of the export proceeds within the specified period i.e., nine months or as the case may be, under FEMA Regulations and Foreign Trade Policy 2015-2020 is also deemed to be a trade dispute. The Directorate General for Foreign Trade ('**DGFT**') has established a complaints portal i.e., Quality Control and Trade Disputes ('**QCTD**') for the interest of the Indian and foreign exporters and importers. Under this portal, Indian exporters can register a compliant online on the DGFT website. Such complaint request made by an Indian complainant is thereafter sent to the respective Indian Mission Abroad of the subject country for action.

However, there is not much clarity as to what exact remedies the Indian exporter could expect through this portal, as it is silent on the procedural aspect. However, an assumption could be drawn under a parallel scenario. Where at the same portal, if a foreign importer registers a complaint against the Indian exporters, then in accordance with the provisions of the Foreign Trade (Development and Regulation) Act, 1992 ('**FTDR Act**'), the DGFT investigates such complaints and if found satisfactory, penalties such as suspension or cancellation of Importer Exporter Code (IEC) under Section 9 of the FTDR Act, can be imposed. Accordingly, a similar action could be initiated by the trade regulatory body of the subject foreign country once such complaint is forwarded by the Indian mission abroad to the regulatory body of the subject foreign country.

D. Remedy by filing suit against the erring foreign importers in the subject foreign country-

The exporters also have the option to file a suit against the erring foreign importers in the importer's country as per their laws. The exporter may engage a lawyer in the subject foreign country and file civil proceedings for the recovery of money or an insolvency application or any other action against such foreign importer, as advised by the foreign lawyer.

Options under the FEMA laws with respect to contravention for non-repatriation:

Generally, if exporters fail their obligations, they are deemed to be under contravention. While the aforesaid are the remedies for recovery of amounts/ ensuing repatriation of export proceeds, the FEMA laws also allow certain additional options for the exporters to explore:

A. Representation before the Authorised Dealer Bank and/ or the RBI-

As per the Export Master Directions as well as FEMA Regulations, the exporters who fail their obligation, can make a representation before the Authorised Dealer Bank ('**Bank**') describing the reasonable steps taken by them for the realization of the export payment. As per Para. C.20 of the Export Master Directions, the Bank, after analyzing whether the exporter failed to realize the payment because of reasons beyond exporter's control, may take a decision of extending the period of export realization for up to six months and not beyond.

The exporters seeking certain specific remedy/ directions beyond the ambit of the Bank, may make a representation before the regional office of the RBI. After analyzing such representation, certain directions can be issued by the RBI as it deems to be expedient for the purpose of securing the payment.

B. Write-off-

As per Para. C.23 of the Export Master Directions, the exporters have an option to self write-off the unrealized export bills. They may also approach the Bank to write-off such bill if the exporter is desirous of writing-off beyond the threshold limit of 5% of the total export proceeds realized during the calendar year preceding the year in which the write-off is being done. The Bank, in such cases, can allow write-off up to a threshold of 10% of the same value.

C. Compounding-

For exporters who failed to take any reasonable steps for realization, and further failed to seek any direction from the RBI for extension / write-off, or if the RBI refused to give such directions, there are sufficient grounds for the concerned authority to initiate proceedings for contravention under FEMA. As per Section 13 of the FEMA, a penalty up to thrice the sum involved in such contravention may be imposed. This can also be considered as a continuing offence if the exporter did not take any action even after the expiry of the stipulated period.

The exporter can, therefore, consider going for compounding of the offence, as per the procedures mentioned under the Master Direction – Compounding of Contraventions under FEMA, 1999, as soon as possible in order to mitigate the effect of continuing offence.

Way forward

These days, there are certain ways through which the exporters can secure their export payments such as relying on a Letter of Credit, Documentary Drafts, etc. However, the most effective amongst them is export credit guarantees. A range of export credit guarantees are provided by the Export Credit Guarantee Corporation of India Limited in the form of insurance covers to the Indian exporters against the risk of non-realization of export payments. Conclusively, it may be borne in mind that the loss of export payments is not an individual loss but the loss of nation's foreign exchange, which affects India's balance of payments. Hence, in all these ways, the exporters may strive to secure their export payments.

[The author is an Associate in the Corporate and M&A advisory practice at Lakshmikumaran & Sridharan Attorneys, Hyderabad]

Notifications and Circulars

Declaration by auditor – Companies (Acceptance of Deposits) Rules 2014 amended: The Ministry of Corporate Affairs has, *vide* Notification G.S.R. 663(E), dated 29 August 2022, amended the Companies (Acceptance of Deposits) Rules, 2014, to provide for an additional requirement of declaration to be submitted by the auditor of the company. In this regard, Rule 16, dealing with the return of deposits to be filed with the registrar, has been amended to insert the words "*and declaration to that effect shall be submitted by the auditor in Form DPT-3*" after the words "*auditor of the company*". Form DPT-3 and Form DPT-4 have also been revised to provide for the declaration to be submitted by the auditor, pursuant to Rules 16, 16A and 20 of the Companies (Acceptance of Deposits) Rules, 2014.

Signing of e-forms by RP – Companies (Registration of Charges) Rules 2014 amended: The Ministry of Corporate Affairs has, *vide* Notification G.S.R. 664(E) dated 29 August 2022, amended the Companies (Registration of Charges) Rules, 2014 to provide for an additional requirement of signing of charge e-forms by insolvency resolution professional or resolution professional or liquidator for companies under resolution or liquidation. In this regard, Rule 13 shall be inserted in the Companies (Registration of Charges) Rules, 2014. Further, Forms CHG-1, CHG-4, CHG-8, and CHG-9 have also been revised consequently.

Small companies – Companies (Specification of Definition details) Rules, 2022 amended: The Ministry of Corporate Affairs has amended the Companies (Specification of Definition Details) Rules, 2014, to revise the threshold limit for paid-up capital and turnover of small companies. *Vide* Notification G.S.R. 700(E) dated 15 September 2022, the threshold limit of paid-up capital and turnover has been increased to INR 4 crore (earlier INR 2 crore) and INR 40 crore (earlier INR 20 crore), respectively. In this regard, Rule 2(1)(t) of the Companies (Registration of Charges) Rules, 2014 has been substituted.

Overseas Direct Investment – New regime notified: The Ministry of Finance, including the RBI, have recently notified the Foreign Exchange Management (Overseas Investment) Regulations, 2022, the Foreign Exchange Management (Overseas Investment) Rules, 2022, and the Foreign Exchange Management (Overseas Investment) Directions, 2022 to bring into force the new regime for overseas investments by persons resident in India. The new regime simplifies the existing framework for overseas investment by persons resident in India to cover wider economic activity, and significantly reduces the need for seeking specific approvals. It also reduces the compliance burden and associated compliance costs. According to the Directions, the new Rules and Regulations enhance clarity with respect to various definitions; introduce the concept of strategic sector; dispense with the requirement of approval for deferred payment of consideration, investment/disinvestment by persons resident in India under investigation by any investigative agency/regulatory body, issuance of corporate guarantees to or on behalf of second or subsequent level step down subsidiary (SDS), and write-off on account of disinvestment. The new regime also introduces Late Submission Fee (LSF) for reporting delays. Some of the important changes are highlighted below:

- Extant concept of Joint Venture (JV) and Wholly Owned Subsidiary (WOS) is substituted under the new regime with the concept of foreign entity.
- Overseas Direct Investment (ODI) can be made in certain strategic sectors (such as oil, gas, coal, mineral ores, submarine cable system and start-ups) in unincorporated entities as well.
- Concept of 'Indian Party' has been substituted with 'Indian Entity'.
- 'Overseas Portfolio Investment (OPI)' means investment, other than ODI, in foreign securities.
- Person resident in India may make or transfer any investment or financial commitment outside India under general permission/automatic route subject to the provisions contained in the Rules, Regulations and Directions.

Guidelines for preferential issue and institutional placement of units by listed InvITs and REITs revised: The Securities and Exchange Board of India (SEBI) has amended the guidelines for the preferential issue and institutional placement of units by listed Infrastructure Investment Trusts (InvITs) and Real Estate Investment Trusts (REITs).

Vide Circulars Nos. SEBI/HO/DDHS/DDHS_Div3/P/CIR/2022/0115 and 0116, both dated 26 August 2022, post allotment, the InvITs/REITs shall make an application for listing of the units to the stock exchange(s), and the units shall be listed within two (2) working days from the date of allotment, and in case of default, the monies received shall be refunded through verifiable means within four (4) working days from the date of the allotment. Further, if any such money is not repaid within such time, then the REIT or InvIT, manager of such units, and its director or partner would be jointly and severally liable to repay that money with interest at the rate of fifteen (15) percent per annum from the expiry of the fourth working day.

Regarding the pricing of frequently traded units, the price of units to be allotted pursuant to the preferential issue shall not be less than higher of the following:

i. 90 trading days' volume weighted average price of the related units quoted on the recognized stock exchange preceding the relevant date, or

ii. 10 trading days' volume weighted average prices of the related units quoted on a recognized stock exchange preceding the relevant date.

Furthermore, a preferential issue of units to 'institutional investors', not exceeding five in number, shall be made at a price not less than the 10 trading days' volume weighted average prices of the related units quoted on a recognized stock exchange preceding the relevant date.

As per the guidelines, the preferential issue of units shall not be made to any person who has sold or transferred any units of the issuer during the 90 trading days preceding the relevant date. Further, where any person belonging to the sponsor has sold/transferred their units of the issuer during the 90 days preceding the relevant date, all sponsors shall be ineligible for allotment of units on a preferential basis.

However, the restriction shall not apply to a sponsor in case any asset is being acquired from that sponsor(s), and the preferential issue of units is being made as full consideration for the acquisition of such asset.

Overseas investment by Alternative Investment Funds / Venture Capital Funds – SEBI notifies guidelines: The Securities and Exchange Board of India has, *vide* Circular No. SEBI/HO/AFD-1/PoD/CIR/P/2022/108 dated 17 August 2022, notified guidelines for overseas investment by Alternative Investment Funds (AIFs) / Venture Capital Funds (VCFs), under which the requirement of the overseas investee company to have an Indian connection has been done away with.

As per the guidelines, AIFs/VCFs shall invest in an overseas investee company which is incorporated in a country whose securities market regulator is a signatory to the International Organization of Securities Commission's Multilateral MoU or a signatory to the bilateral MoU with SEBI.

However, AIFs/VCFs shall not invest in an overseas investee company, which is incorporated in a country identified in the public statement of the Financial Action Task Force (FATF), as:

(a) a jurisdiction having a strategic Anti-Money Laundering or Combating the Financing of Terrorism deficiencies to which counter measures apply, or

(b) a jurisdiction that has not made sufficient progress in addressing the deficiencies or has not committed to an action plan developed with FATF to address the deficiencies.

Further, if an AIF/VCF liquidates an investment made in an overseas investee company previously, the sale proceeds received from such liquidation to the extent of the investment made in the said overseas investee company shall be available to all AIFs/VCFs (including the selling AIF/VCF) for reinvestment.

Furthermore, AIFs/VCFs shall transfer/sell the investment in the overseas investee company only to the entities eligible to make overseas investments.

In this regard, AIFs/VCFs shall furnish the sale/divestment details of the overseas investments to SEBI (in a specified format), within 3 working days of the divestment, and all the overseas investments sold/divested by AIFs/VCFs till date shall also be reported to SEBI within 30 days.

Insolvency Professional – IBBI (Insolvency Professionals) Regulations, 2016 amended: The Insolvency and Bankruptcy Board of India ('**IBBI**') has notified the IBBI (Insolvency Professionals) (Second Amendment) Regulations, 2022 which inserts Regulation 26A in the IBBI (Insolvency Professionals) Regulations, 2016. According to the new Regulation, an insolvency professional shall not accept/ share any fees or charges from any professional and/ or support service provider who is appointed under the processes. The new regulation is effective from 13 September 2022.

Fees to interim resolution professional and resolution professional – IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 amended: The IBBI has amended the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 to insert new Regulation 34B relating to fee to be paid to interim resolution professional and resolution professional. Accordingly, the fee of the interim resolution professional or the resolution professional, appointed on or after 1 October 2022, shall not be less than the fee specified in clause 1 for the period specified in clause 2 of the new Schedule-II (also inserted by the amendment). It may be noted that the new Schedule provides for minimum fixed fee, period for minimum fixed fee, and performance-linked incentive fee for timely resolution and performance-linked incentive fee for value maximisation. IBBI (Insolvency Resolution Process for Corporate Persons) (Third Amendment) Regulations, 2022 dated 13 September 2022 has been issued for the purpose.

Sale of one or more of assets of the corporate debtor – IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 amended: The IBBI has amended the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 on 16 September 2022 for the fourth time this year. The latest set of amendments in Regulation 36B enable the resolution professional and the Committee of Creditors to issue request for resolution plan a second time for sale of one or more of assets of the corporate debtor in cases where no resolution plan has been received for the corporate debtor as a whole. Further, amendments in Regulation 37 enable for a resolution plan to include sale of one or more assets of corporate debtor to one or more successful resolution applicants submitting resolution plans for such assets and providing for appropriate treatment of the remaining assets. Also, amongst other changes, a new Regulation 36C has been inserted to provide for strategy for marketing of assets of the corporate debtor. According to this new regulation, the resolution professional shall prepare a strategy for marketing of the assets of the corporate debtor in consultation with the committee, where the total assets as per the last available financial statements exceed one hundred crore rupees and may prepare such strategy in other cases.

Ratio Decidendi

Having purchased the corporate debtor in a slump sale, successful bidder cannot thereafter request to convert it into a sale as a going concern

The National Company Law Tribunal, Ahmedabad Bench ('**NCLT**') has held that having first accepted and purchased the Corporate Debtor in a slump sale, the bidder, thereafter, cannot request to treat or convert such slump sale into a sale of the Corporate Debtor as a going concern.

Brief facts:

An application under Section 7 of the Insolvency and Bankruptcy Code, 2016 ('**IBC**'/ '**Code**') was filed by the Appellant seeking initiation of Corporate Insolvency Resolution Process ('**CIRP**') against the Respondent-Corporate Debtor, which was admitted. Subsequently, on the failure of CIRP, an order for liquidation was passed by NCLT. Despite efforts of the appointed Liquidator to sell the Corporate Debtor as a going concern, no prospective buyers turned up. Finally, the Liquidator disposed of the Corporate Debtor as a slump sale where the successful bidder was Jindal Power Ltd. ('**Successful Bidder**'). Thereafter, the Successful Bidder filed an application before the NCLT Bench to convert this slump sale into a sale of the Respondent-Corporate Debtor as a going concern and allow the Bidder to have all benefits as of approved Resolution Plan as per Sections 31 and 32A of the IBC.

Submissions by the Applicant/ successful bidder:

- It was submitted that it is the main object of the IBC to promote entrepreneurship and preserve the existence of the corporate debtor. If the Liquidator is directed to treat this sale as a going concern, then all stakeholders would be benefited, and employment will be generated.
- It was further submitted that if the Liquidator is directed to treat the slump sale as sale as a going concern, none of the interested parties including stakeholders' committee, would be affected prejudicially.

Submissions by the Respondent-Corporate Debtor:

- It was submitted that once sale is concluded, the Successful Bidder then cannot put the condition upon the Liquidator to issue the sale certificate to treat the sale as a going concern.
- It was further submitted that the Liquidator has no authority to convert the slump sale into the sale as a going concern and the application is not maintainable before the NCLT. Such conversion cannot be allowed without the consultation with the stakeholders' committee.

Decision:

The NCLT relied on the case of *Visisth Services Limited* v. *S.V. Ramani and Ors.*, Company Appeal (AT) (Insolvency) No. 896 of 2020, where the question was *whether bidders can put certain conditions while accepting the bid and in case the conditions are not complied with then whether it can cancel the sale itself and claim the EMD amount* was dealt with. The NCLT held that, in the present case, as there is no condition put by the Applicant at the time of purchasing the Corporate Debtor, no leeway can be given for such conversion. The NCLT, in the present case, ruled that the *slump sale cannot be treated / converted into a sale as a going concern*, since there is a vast difference between the sale price of the corporate debtor as a going concern (earlier fixed as INR 4,33,16,59,500/-) and the sale price of the corporate debtor in a slump sale (final bid value as INR 3,14,38,49,770/-). It was held that, if the Bidder's request is allowed, then the rights of members of the stakeholders' committee will be affected prejudicially. Thus, the NCLT held that this application is not maintainable and accordingly a sale certificate for sale as a going concern cannot be issued.

[*Jindal Power Ltd.* v. *Liquidator, Shirpur Power Pvt. Ltd.* along with *State Bank of India & Anr.* v. *Shirpur Power Pvt. Ltd.* – Order dated 2 August 2022 in C.P.(I.B.) No. 487/7/NCLT/AHM/2018, National Company Law Tribunal, Ahmedabad]

Resolution Plan ignoring dues of State Government/Legal Authority to be rejected

The Supreme Court has held that if the Resolution Plan ignores the statutory demands of any State Government or a legal authority, altogether, the Adjudicating Authority is bound to reject the Resolution Plan.

Brief facts:

In the Corporate Insolvency Resolution Process (CIRP) initiated for the Respondent-Corporate Debtor, the State Tax Officer ('**Appellant**') had filed its claim before the Resolution Professional (RP) seeking payment of total dues of INR 47,35,72,314/- towards Value Added Tax/ Central Sales Tax, on the ground that the Sales Tax Officer is a Secured Creditor. This was done on the premise that, u/s. 48 of the Gujarat Value Added Tax, 2003 ('**GVAT Act**'), the State had first charge over the properties of the defaulting dealer. The Appellant had already initiated recovery proceedings against the Respondent-Corporate Debtor much prior to initiation of CIRP, and further had also attached the immovable properties of the Respondent. However, the claim was not taken into consideration in the Resolution Plan approved by the Committee of Creditors (COC), and the National Company Law Tribunal, Ahmedabad Bench ('**NCLT**'), subsequently. On appeal, the claim was further rejected by the National Company Law Appellate Tribunal ('**NCLAT**'). Both rejections were on the ground that the Appellant does not fall within the meaning of 'Secured Creditor' as defined under Section 3(30) read with Section 3(31) of the IBC. Further, the NCLAT held that in the interplay of Section 53 of the IBC and Section 48 of the GVAT Act, Section 48 cannot prevail over Section 53 and the government cannot claim first charge over the property of the Corporate Debtor. The present appeal has been preferred against said orders.

Submission by the Appellant-State before the Supreme Court:

- It was submitted that, since recovery proceedings were already pending prior to initiation of CIRP, the books of accounts of Corporate Debtor would have reflected its liabilities towards the Appellant in respect of statutory duties. Hence, by not taking the claim into consideration, the RP has failed to examine and verify the books. Further, RP has failed to include the details of the debt in the Information Memorandum. Accordingly, the Resolution Plan does not confirm to the statutory requirements and not binding on the Appellant.
- It was submitted there merely by virtue of being an operational creditor, the Appellant is not precluded from being considered as a secured creditor.
- It was submitted that the finding of the NCLAT that the Appellant is not a 'Secured Creditor' is erroneous and contrary to the definition under Section 3(30) of IBC.
- It was further contended that it was not the case of the Appellant whether Section 48 of the GVAT Act prevails over Section 53 of the IBC, but it was the case that the Appellant falls within the purview of 'Secured Creditor'.

Decision:

It was held by the Supreme Court, while setting aside the orders of NCLT and NCLAT, that the understanding that the Appellant is not a Secured Creditor is based on an erroneous premise that Section 48 of the GVAT Act prevails over Section 53 of the IBC. Under Section 53(1)(b)(ii), the debts owed to a Secured creditor, which would include the State under the GVAT Act, are to rank equally with other specified debts including debts on account of workman's dues. Appellant is a Secured Creditor under the GVAT Act. Section 3(30) of the IBC defines Secured Creditor to mean a creditor in favour of whom security interest is credited. Such security interest could be created by operation of law. In the present case, therefore, the Section 48 of the GVAT Act, creates a security interest in favour of the Appellant. It was further held that the fact that the Appellant is an operational creditor does not result in loss of its status as Secured Creditor and that the definition of Secured Creditor in the IBC does not exclude any Government or Governmental Authority.

It was observed by the Apex Court that any grievance made before the Adjudicating Authority with regard to a Resolution Plan should be examined by the RP to meet the requirements of Section 30(2) of the IBC. It casts an obligation on the RP to confirm that the Resolution Plan provides for the payment to the operational creditors. If the Resolution Plan is not as per Section 30(2), then it would not be binding on *inter-alia* any State government to whom a debt in respect of dues arising under any law for the time being in force is owed. The word 'satisfied' used in Section 31(1) further contemplates a duty on the Adjudicating Authority to examine the Resolution Plan. Accordingly, if the Adjudicating Authority upon satisfaction finds that the Resolution Plan does not confirm to the requirements then it may reject a Resolution Plan. In the present case, the Resolution Plan was concluded as ignoring the debt of the Appellant being a State. Therefore, the RP can consider a fresh Resolution Plan with proper consideration of dues of the Appellant.

[*State Tax Officer* v. *Rainbow Papers Limited* – Judgment dated 6 September 2022 in Civil Appeal Nos. 1661/2020 and 2568/2020, Supreme Court]

SEBI Circular on standardisation of procedure for debenture holder trustees has retroactive application

The Supreme Court has recently dealt with the interplay of the SEBI Circular on Standardisation of Procedure for Debenture Trustee(s) in case of 'default' by issuers of listed debt securities ('**SEBI Circular**') dated 13 October 2020 and RBI (Prudential framework for the resolution of stressed assets) Directions, 2019 ('**RBI Circular**') and held that the SEBI Circular shall be applicable retroactively. It was further held that the Debenture Trustee can participate in the Inter-Creditors Agreement ('**ICA**') entered into amongst the lenders, on behalf of debenture holders, as per the SEBI Circular.

Brief facts:

The Respondent issued debentures to various persons ('**Debenture Holders**') and signed Debenture Trust Deeds with one Vistra ITCL (India) Limited ('**Debenture Trustee**'). However, the Respondent committed default in March 2019 and thereafter the lenders entered into an Inter-Creditor Agreement. Pursuant to said Agreement, a Resolution Plan was voted on, in line with the RBI Circular, where the Debenture Holders were given 24.96% of recovery. However, such voting was without the consent of the Debenture Holders. The RBI Circular focused upon the early recognition and resolution of stressed assets. However, it was applicable only on the entities regulated by RBI and not the Debenture Holders. On the other hand, SEBI Circular extended the right to Debenture Holders to provide consent for the Resolution Plan in the ICA since it involved debt restructuring. However, such consent is only for either (i) enforcement of security; or (ii) entering the ICA, which would then bind such Debenture Holders. On 11 March 2021, the Respondent and the Debenture Trustee amended the Debenture Trust Deeds by executing a Supplementary Debenture Trust Deed ('**Supplementary Deed**'), which took note of the SEBI Circular. The Debenture Holders filed a suit before the High Court of Bombay stating that even though the voting on resolution under the ICA was done after issuance of SEBI Circular, the same cannot be applicable retrospectively upon the Debenture Holders and further, they sought the declaration that the RBI Circular is 'illegal' and '*ultra-vires*' as *inter-alia* it allowed illegal distribution of funds into creditors without considering their status as secured or secured and without Debenture Holder's consent, and therefore its implementation be restrained.

The Bombay High Court opined *prima facie* that a meeting of debenture holders was required and suggested that all the concerned parties enter into a negotiated settlement. Accordingly, they were offered a final recovery of 29.96% as full and final settlement. However, the court held that the SEBI Circular could not be permitted to operate retrospectively so as to seek an ex-post facto consent from the Debenture Holders for either the ICA or the Resolution Plan. On appeal to the Division Bench, the Court upheld the decision of the Single Judge Bench, while rejecting the argument that the consent of the debenture holders at the International Securities

Identification Number (**ISIN**) level is necessary before a Resolution Plan could be implemented. The Division Bench further held that the SEBI Circular is applicable only if the Debenture Holders are proposing to enforce their security or enter into an ICA, but the same was not the case here. Hence, this present appeal was filed by the 'Appellant to challenge the order of the Division Bench and allow the retrospective application of SEBI Circular.

Submission by the Appellant:

- Supplementary Deed was signed only for the purpose of aligning the Debenture Trust Deed with the SEBI Circular and therefore, the parties were aware that the Circular is applicable.
- SEBI Circular is retroactive in nature, since it does not travel backwards and impair vested rights. It was brought into force before the voting on resolution took place, and therefore, the voting must take place in accordance with it.
- The argument that ISIN level wise meet would lead to a situation where a debenture holder of one ISIN level could veto the entire Resolution Plan is not sustainable as the issuer company can always adjust the size of the security.
- after the issuance of the SEBI Circular, restructuring of debt is possible in two ways only: (i) a compromise independent of the NCLT under SEBI Circular; or (ii) approaching the NCLT under Section 230 of the Companies Act, 2013. Therefore, the Bombay High Court incorrectly allowed for a negotiated settlement or consideration of the Resolution Plan in accordance with the terms of the Debenture Trust Deeds.

Submission by the Respondent

- Regulation 15(7) of the SEBI (Debenture Trustees) Regulations, 1993 provides that the debenture trustees must sign the ICA on behalf of the debenture holders before considering the Resolution Plan, but it is not a mandatory but a facilitative provision. Therefore, SEBI Circular is not the only way to enter into a compromise and the same does not exclude the provision of Sections 62 and 63 of the Indian Contract Act, 1872.
- ISIN Voting would enable a single ISIN number to defeat the entire Resolution Plan.
- SEBI Act does not provide for retrospective or retroactive application of subordinate legislation as the SEBI Circular is administrative in nature.
- SEBI Circular is not only retroactive, but retrospective since it impairs the vested right of the Debenture Holder under Debenture Trust Deed i.e., right to sanction any compromise or arrangement with the company and the Supplementary Trust Deed does not override the same.

Decision:

It is the Respondent's case that the SEBI Circular is applicable only *if debenture holders choose to enter an ICA* i.e., they may choose not to enter into an ICA and instead approve or reject the Resolution Plan under the ICA, independent of SEBI Circular modalities. However, the ICA and Resolution Plan are intertwined, since the SEBI Circular directly states *inter-alia* that *investors in debt securities can be approached by other lenders to sign an ICA under specific terms as stipulated by RBI*. Even though ICA is not the only route for the Debenture Holders to enter a compromise but *if they choose* to enter through this route by majority consent, the procedure prescribed in the SEBI Circular needs to be followed which requires either entering an ICA or enforcing of the security.

The Court did not discuss on the matter whether ISIN voting would defeat the entire Resolution Plan, especially in case where there is no provision of exiting the ICA/Resolution Plan, because there was no challenge to the SEBI Circular. However, the Court noted that neither under a compromise under Section 230 of the Companies Act, 2013 or under the SEBI Circular, the dissenting creditors can exit the compromise.

The SEBI Circular shall have a retroactive application since it does not take away or impair any vested rights. The Court relied on *Vineeta Sharma* v. *Rakesh Sharma*, (2020) 9 SCC 1 and *State Bank's Staff Union (Madras Circle)* v. *Union of India*, 2005 7 SCC 584 to arrive at the decision, and discussed the nature of retroactive laws. It has been observed that such a law *operates in the future, but its operation is based upon the character which happened in the past or requisites which had been drawn from the antecedent events.* 'Quasi-retroactivity' occurs when a new rule of law is applied to an act or transaction in the process of completion. In the present case, the Respondent defaulted on payments prior to the SEBI Circular and, as on 13 October 2020, no compromise or arrangement in regard to the restructuring of debt existed. However, the Resolution Plan was entered after issuance of SEBI Circular therefore applying principles of Quasi-retroactivity, the SEBI Circular shall be applicable to the manner of the resolution of debt. Further, Clause 22 and 23 of the Debenture Trust Deeds dealing with power of Debenture Holders regarding sanctioning of compromise requires three-fourth majority. However SEBI Circular allows compromise even if there is 60% majority by ISIN level voting. Therefore, SEBI Circular will take precedence before the contractual arrangements as force of law.

In the present case, the Court exercised Article 142 of the Constitution of India i.e., power of the court to make a decision based on equitable principles where provisions of law cannot do complete justice. Since the Resolution Plan was already voted on and the Debenture Holders were getting maximum recovery i.e., 29.96% of the principle amount which is greater than the recovery of other lenders, in such a situation, application of SEBI Circular, though right in law, may lead to unjust outcomes for the retail Debenture Holders if the court reversed the entire course of action and applied the circular retroactively. Therefore, for the present case, the implementation of the SEBI Circular was not considered. However, this does not set a precedent and SEBI Circular stands applicable retroactively.

[*Securities and Exchange Board of India* v. *Rajkumar Nagpal and Ors.* – Judgment dated 30 August 2022 in Civil Appeal No. 5247 of 2022, Supreme Court]

News Nuggets

IBC prevails over Customs Act – Customs cannot recover dues once moratorium imposed

A 3-Judge Bench of the Supreme Court has held that the provisions of the Insolvency and Bankruptcy Code, 2016 (IBC) will prevail over the provisions of the Customs Act, 1962. The Court in *Sundaresh Bhatt* v. *Central Board of Indirect Taxes & Customs* [Judgment dated 26 August 2022] said that once a moratorium is imposed in terms of Section 14 or 33(5) of the IBC, customs authorities do not have the power to initiate the proceedings for recovery of dues by means of sale/confiscation, as provided under the Customs Act. It was of the view that demand notices to seek enforcement of customs dues during the moratorium period would violate said provisions of the IBC.

The Court was of the view that customs authority only has limited jurisdiction to assess/determine the quantum of customs duty and other levies, and after such assessment, it has to submit its claims (concerning customs dues/operational debt) in strict compliance with the time periods prescribed under the IBC, before the adjudicating authority. The Court was of the view that issuing a notice under Section 72 of the Customs Act, for non-payment of customs duty, falls within the ambit of initiating legal proceedings against a corporate febtor. The Apex Court in this regard also noted that there was no abandonment of goods by the corporate debtor/appellant.

Accordingly, allowing the appeal challenging the order of NCLAT, the Apex Court said that the liquidator can immediately secure goods from the customs authority to be dealt with appropriately in terms of the IBC. In the present case, the containers were imported between 2012 to 2015, the CIRP was initiated in 2017 and the corporate debtor went into liquidation in 2019. The notice under Section 72 of the Customs Act, 1962 was issued for the first time in 2019 only.

Insolvency – Threshold monetary limit for initiating CIRP can be met jointly

The Rajasthan High Court has held that a group of financial creditors can converge and join hands to touch the financial limit of INR 1 crore stipulated under Section 7 of the Insolvency and Bankruptcy Code, 2016 ('IBC') to initiate Corporate Insolvency Resolution Process (CIRP under the IBC. The Court in *Vishnu Oil Mill Pvt. Ltd.* v. *Union of India* [Judgment dated 7 July 2022] noted that Section 7 stipulated that the application for initiating CIRP may be initiated by a financial creditor either individually or jointly with other financial creditors, and that if the threshold limit was to be fixed at INR 1 crore *qua* each individual financial creditor, then there was no reason whatsoever for allowing joint applications by financial creditors. It also noted that in cases of MSMEs, there may not exist financial creditors whose individual debt is INR 1 crore or above, to arrive at the decision.

Insolvency – Erstwhile Insolvency Professional not entitled to be heard by Adjudicating Authority before decision on replacement

The National Company Law Appellate Tribunal's ('**NCLAT**'), Principal Bench, has held that there is no warrant to permit a *lis* (proceedings) to be raised by the Resolution Professional challenging his replacement by the Committee of Creditors ('**CoC**'). While hearing an appeal against National Company Law Tribunal ('**NCLT**') Chandigarh bench's order, the NCLAT observed that the scheme of Section 27 of the Insolvency and Bankruptcy Code ('**IBC**') does not indicate that Resolution Professional is to be made party and is to be issued notice before taking decision to appoint another Resolution Professional. The NCLAT, in the case of *Sumat Kumar Gupta* v. *Committee of Creditors of M/s Vallabh Textiles Company Ltd.* [Decision dated 2 September 2022], has held that the scheme of Section 27 by implication excludes the principles of natural justice, and does not provide for an opportunity of hearing to the appellant.

Arbitration agreement embedded in a contract is a separate and severable clause

The Delhi High Court has reiterated that an arbitration agreement embedded in a contract is always considered a separate and severable clause, with a standing of its own; by reason of the same, the supersession of an arbitration agreement must not be lightly inferred. Citing the principle 'when in doubt, do refer' from the Supreme Court judgment in the case of *Intercontinental Hotels Group (India)* v. *Waterline Hotels*, the High Court in *Shristi Infrastructure Development Corporation Ltd.* v. *Ircon International Ltd*. [Judgment dated 5 August 2022] was of the view that if there is an arbitration agreement between the parties, which is sought to be negated by a party by citing other provisions of a contract, which requires interpretation of the contract, courts must lean towards referring the matter to arbitration.

The Petitioner had filed for the appointment of arbitrator under Section 11 of the Arbitration & Conciliation Act, 1996, and the Respondent had contended that there was a settlement of dispute provision in the Special Conditions of Contract (SCC) which would supersede the clauses in General Conditions of Contract (GCC). Observing that there was no evident conflict or inconsistency between the arbitration clause comprised of the GCCs and the SCCs, the Court said that though the SCCs gave an overriding effect to the GCCs, such effect was restricted only to the extent there is a conflict or inconsistency between the provisions of the two contracts.

Allowing the petition and appointing an arbitrator with regard to the issues of arbitrability and validity, the Court said that the arbitrator must be left free to decide on his/her own jurisdiction including the existence of the arbitration agreement, as permissible under Section 16 of the Arbitration & Conciliation Act, 1996.

Arbitration – Failure to mention seat of arbitration and participation in arbitration proceedings without any protest to be considered as determination of venue and seat

The Allahabad High Court has held that an order rejecting an application seeking return of the application filed under Section 34 of the Arbitration and Conciliation Act, 1996 ('**Arbitration Act**') involves no adjudication under Section 34, and hence it is not appealable under Section 37 of the Arbitration Act. The High Court, in the case of *Zapdor-Ubc-Abn (JV) Delhi* v. *Union of India*, [Decision dated 15 September 2022], further ruled that failure to specifically mention a seat of arbitration and participation in arbitration proceedings at New Delhi by the Respondents without any protest would be considered as determination *of the venue of arbitration as also the seat, by their conduct.* The Court further stated that this would give exclusive jurisdiction to the Courts at New Delhi to supervise the arbitral proceedings including any attack on the award. Referring to the Apex Court's decision in the case of *BGS SGS Soma JV* v. *NHPC Ltd.,* 2004 (4) SCC 234, the bench stated that the Supreme Court understood it as necessary to lay down the law on what constitutes 'juridical seat' of the arbitral proceedings and observed that once the seat is delineated by the arbitration agreement, the Courts at the place of the seat would alone thereafter have exclusive jurisdiction over the arbitral proceedings.

Person availing services of bank covered under definition of 'consumer' under Consumer Protection Act, 1986

The Supreme Court has held that a person who avails of any service from a bank will fall within the purview of the definition of a 'consumer' under the Consumer Protection Act, 1986, and consequently, it would be open to such a consumer to seek recourse to the remedies provided under the said Act. The case in *Arun Bhatiya* v. *HDFC Bank* [Judgment dated 8 August 2022] involved opening of a joint FD account by the Appellant along with his father which was prematurely encashed on instruction of one person (not both). Observing that the dispute was between the Appellant and his father, the State Consumer Disputes Redressal Commission ('**SCDRC**') had relegated the Appellant to pursue his claim before the civil court. The Supreme Court however observed that there was manifest error on the part of the SCDRC in declining to entertain the consumer complaint on merits.

Commercial suits – Pre-litigation mediation is mandatory – No absolute right to file a civil suit

The Supreme Court has held that statutory pre-litigation mediation contemplated under Section 12A of the Commercial Courts Act, 2015 ('**Act**'), as inserted by the Commercial Courts (Amendment) Act, 2018, is mandatory. Relying upon various case laws, the Court in *Patil Automation Private Limited* v. *Rakheja Engineers Private Limited* [Judgment dated 17 August 2022] held that Section 12A cannot be described as a mere procedural law. It was of the view that exhausting pre-institution mediation by the plaintiff, with all the benefits that may accrue to the parties and, more importantly, the justice delivery system, would make Section 12A not a mere procedural provision. According to the Court, the design and scope of the Act, as amended in 2018, by which Section 12A was inserted, would make it clear that the Parliament intended to give it a mandatory flavour. The Apex Court in this regard noted that Section 12A provides for a bypass and a fast-track route without for a moment taking the precious time of a court into consideration. Noting that pre-institution mediation has been mandated only in a class of suits (which do not contemplate any urgent interim relief), the Court held that carving out of a class of suits and selecting them for compulsory mediation, harmonises with the attainment of the object of the law. The Supreme Court also observed that there is no fundamental right with anyone to file a civil suit, which cannot be taken away, and that it cannot, in one sense, be argued that no legal right of the defendant is infracted.

NEW DELHI
5 Link Road, Jangpura Extension,
Opp. Jangpura Metro Station,
New Delhi 110014
Phone : +91-11-4129 9811

B-6/10, Safdarjung Enclave
New Delhi -110 029
Phone : +91-11-4129 9900
E-mail : lsdel@lakshmisri.com

MUMBAI
2nd floor, B&C Wing,
Cnergy IT Park, Appa Saheb Marathe Marg,
(Near Century Bazar)Prabhadevi,
Mumbai - 400025
Phone : +91-22-24392500
E-mail : lsbom@lakshmisri.com

CHENNAI
2, Wallace Garden, 2nd Street
Chennai - 600 006
Phone : +91-44-2833 4700
E-mail : lsmds@lakshmisri.com

BENGALURU
4th floor, World Trade Center
Brigade Gateway Campus
26/1, Dr. Rajkumar Road,
Malleswaram West, Bangalore-560 055.
Phone : +91-80-49331800
Fax:+91-80-49331899
E-mail : lsblr@lakshmisri.com

HYDERABAD
'Hastigiri', 5-9-163, Chapel Road
Opp. Methodist Church,
Nampally
Hyderabad - 500 001
Phone : +91-40-2323 4924
E-mail : lshyd@lakshmisri.com

AHMEDABAD
B-334, SAKAR-VII,
Nehru Bridge Corner, Ashram Road,
Ahmedabad - 380 009
Phone : +91-79-4001 4500
E-mail : lsahd@lakshmisri.com

PUNE
607-609, Nucleus, 1 Church Road,
Camp, Pune-411 001.
Phone : +91-20-6680 1900
E-mail : lspune@lakshmisri.com

KOLKATA
2nd Floor, Kanak Building
41, Chowringhee Road,
Kolkatta-700071
Phone : +91-33-4005 5570
E-mail : lskolkata@lakshmisri.com

CHANDIGARH
1st Floor, SCO No. 59,
Sector 26,
Chandigarh -160026
Phone : +91-172-4921700
E-mail :lschd@lakshmisri.com

GURUGRAM
OS2 & OS3, 5th floor,
Corporate Office Tower,
Ambience Island,
Sector 25-A,
Gurgaon-122001
Phone : +91-124-477 1300
E-mail : lsgurgaon@lakshmisri.com

PRAYAGRAJ (ALLAHABAD)
3/1A/3, (opposite Auto Sales),
Colvin Road, (Lohia Marg),
Allahabad -211001 (U.P.)
Phone : +91-532-2421037, 2420359
E-mail : lsallahabad@lakshmisri.com

KOCHI
First floor, PDR Bhavan,
Palliyil Lane, Foreshore Road,
Ernakulam Kochi-682016
Phone : +91-484 4869018; 4867852
E-mail : lskochi@laskhmisri.com

JAIPUR
2nd Floor (Front side),
Unique Destination, Tonk Road,
Near Laxmi Mandir Cinema Crossing,
Jaipur - 302 015
Phone : +91-141-456 1200
E-mail : lsjaipur@lakshmisri.com

NAGPUR
First Floor, HRM Design Space,
90-A, Next to Ram Mandir, Ramnagar,
Nagpur - 440033
Phone: +91-712-2959038/2959048
E-mail : lsnagpur@lakshmisri.com

www.lakshmisri.com **www.gst.lakshmisri.com**
www.addb.lakshmisri.com **www.lakshmisri.cn**