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Indian startups – A booming revolution

By **Sudish Sharma and Shikha Thakkar**

In the past few decades, startups have received proliferating attention globally. Today, startups are identified as vital engines for economic growth and job genesis. They transform the market with their high tech and dynamic solutions and with the support of a strong and nurturing ecosystem, they aspire to metamorphose into leading global businesses.

In India, the number of startups has increased velociously. With the support of the government and due to the colossal commercial potential for startups, India has moved up to the third position on the global list. Initiatives, projects and government missions such as 'Startup India', 'Digital India' and 'Vocal for Local' have provided a nurturing grass root level support to the startups in their initial development years.

Few such initiatives taken by the Indian government recently to boost the Indian startups are mentioned hereunder:

Startup India Seed Fund Scheme ('SISFS')

- The Union Budget 2021 was launched with a focus on reviving healthcare, education, fintech, infrastructure and other sectors, impacted by the global pandemic, Covid-19.
- For the efficacious fulfillment of the same, Indian government has sanctioned the sector-agnostic SISFS for providing financial assistance to startups *via* corpus of INR 945 Crore to be disbursed through selected incubators across India from the year 2021 to 2025.
- A startup, recognized by the Department for Promotion of Industry and Internal Trade, incorporated not more than 2 years ago at the time of application under SISFS, is eligible to avail benefit of SISFS.
- SISFS is expected to elevate startups by providing them adequate funds to meet their capital requirement *via* incubators.

Listing norms for startups

- The global startups have been accessing both national and international markets to raise capital. In India, typically, main sources for the same were venture capital and the private equity route.
- The Securities Exchange Board of India, being conscious of the lack of avenues available for sourcing capital, introduced Institutional Trading Platform ('**IIT**') and renamed it as Innovators Growth Platform ('**IGP**'). Introduced under the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, the IGP will extend the deserved support to the new-age national startups to access the capital markets.
- Further, on 14 December 2020, SEBI issued a consultation paper reviewing the IGP framework and made some key recommendations, which include:

(a) ***Eligibility criteria:***

SEBI earlier reduced the requirement of pre-issue capital to be held by eligible investors from 50% to 25% for a period of minimum 2 years in 2019. Now, SEBI has proposed to reduce the period of aforementioned holding from 2 years to 1 year. This will help the startups in attracting investors who are inclined for an early listing at the time of investing in startups.

(b) ***Differential Voting Rights (DVR) / Superior Voting Right (SR) equity shares:***

Companies listed under IGP may be allowed to issue differential voting right or superior voting right equity shares to the founder and promoters, as allowed for companies listed on Main Board[1]

(c) ***Takeover requirements:***

SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 2011 stipulates a 25% threshold for triggering an open offer. Since, life cycle of start-up companies eventually lead them to get merged or acquired by a larger company, stringent takeover requirements, may become a roadblock in such scenarios. Thus, the threshold trigger for open offer is proposed to be relaxed from 25% to 50%.

(d) ***Migration to Main Board:***

IGP company shall be eligible to trade on the main board of the stock exchange provided it fulfills certain conditions.

In this regard, SEBI has proposed to reduce one such eligibility requirement of capital to be held by Qualified Institutional Buyers from 75% to 40% in order to apply for migration to the main board by startups.

Corporate restructuring of startups:

- The Ministry of Corporate Affairs notified the Companies (Compromises, Arrangements and Amalgamations) Amendment Rules, 2021 pursuant to which the benefits pertaining to fast track merger can now be availed by:

  (a) two or more startup companies; or

  (b) one or more startup companies with one or more small companies.

- This amendment has simplified the restructuring avenue for startups by approaching the concerned Regional Director instead of the National Company Law Tribunal.

- Further, the new-age startups are a step closer to exploring the option of swiftly multiplying its resources by joining hands with another startup or small company and advance innovation driven businesses. In this regard, it may also be noted that the thresholds for qualifying as a small company has also been increased which is also a welcome change.

Conclusion

Majority of startups are developing next generation technological solutions including artificial intelligence, internet of things and blockchains. However, owing to current pandemic, the pace of funding activities has been reduced. National and international investors are

[1] Main board means a recognized stock exchange having nationwide trading terminals, other than SME exchange.

themselves facing Covid-19 induced economic slowdown. This is deterring the startups to foster and flourish their innovative brain-child.

Getting past the prevailing economic crisis is the compelling need of the hour and the initiatives taken by Indian Government for startups enunciate a two-fold benefit i.e., (i) accelerating the Indian economy by fueling business of fresh entrepreneurs; and (ii) assisting the startups to survive the present difficult times and thrive in future.

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Notifications and Circulars

One-Person Companies – Companies (Incorporation) Rules, 2014 amended: The Ministry of Corporate Affairs ('**MCA**') *vide* Notification dated 1 February 2021, effective from 1 April 2021, has amended the Companies (Incorporation) Rules, 2014 to ease provisions in relation to One-Person Company ('**OPC**') to convert itself into a Public Company or a Private Company in certain cases and conversion of private company into One-Person Company. Rules 6 and 7 have been substituted/amended for this purpose. Further, Rule 3(1) has been amended wherein for qualifying as resident in India the number of days has been substituted from 182 days to 120 days and natural person has been explained as a person who is an Indian citizen whether resident in India or otherwise.

As per the provisions, the OPC shall alter the Memorandum and the Articles by passing resolution as per Section 122 of the Companies Act, 2013 to give effect to the conversion. The conversion into a private/public company (other than a company registered under Section 8) after increasing the minimum number of members and directors to 2 or 7 members and 2 or 3 directors and maintenance of the minimum paid-up capital as required for such class of company and making due compliance of Section 18 for conversion. The Company's application shall be under e-Form No. INC-16 for conversion along with fees with the following attached documents:

(I) Altered MOA and AOA,

(II) Resolution copy,

(III) List of proposed members and directors with their consent,

(IV) List of creditors, and

(V) Latest audited balance sheet and profit and loss account

Under Rule 7, which is related to conversion of private company into OPC, the paid-up share capital and the turnover limit has been omitted. Lastly, e-Form No. INC-5 has been omitted and a new e-form being introduced for e-Form No. INC-6.

SEBI relaxations in relation to procedural matters: SEBI *vide* Circular dated 19 January 2021 has extended one-time relaxation granted from strict enforcement of certain regulations under SEBI (Issue of Capital and Disclosure)

Requirements, 2018 ('**SEBI ICDR**') to 31 March 2021 for rights issue. Earlier, SEBI *vide* Circular dated 6 May 2020 had provided certain relaxations to listed entities in relation to rights issue opening unto 31 July 2020 under the SEBI ICDR in the light of the pandemic. The relaxations were further extended up to 31 December 2020 by SEBI *vide* its Circular dated 24 July 2020. The relaxations provide that failure to adhere to modes of dispatch through registered post or speed post or courier services due to the prevailing COVID-19 related conditions will not be treated as non-compliance during the said period. Similarly, the MCA *vide* Circulars dated 31 December 2020 and 13 January 2021 had extended relaxations to companies to conduct, through video conferencing or other audio-visual means, their extraordinary general meetings up to 30 June 2021 and annual general meetings up to 31 December 2021. Accordingly, SEBI has, *vide* its Circular dated 15 January 2021, extended the relaxations given to listed entities in respect of sending physical copies of annual reports to shareholders and requirement of proxy for general meetings held through electronic mode, till 31 December 2021.

FCRA Charter issued for Banks and Chartered Accountants: The Foreign Contribution Regulation Act, 2010 ('**FCRA 2010**') was amended in September 2020. One of the major amendment is the mandate of compulsory opening of an FCRA account in the State Bank of India (SBI), Main Branch located at Sansad Marg, New Delhi by each NGO/association registered or given prior permission under FCRA 2010, by 31 March 2021. Each existing FCRA registration holder as well as new applicant for registration or for prior permission would also have to comply with the same. The said 'FCRA bank account' of the NGO would be the first exclusive port of receipt of its foreign contribution in India. However, the NGO/association can open another FCRA account in any PFMS branch of a scheduled bank of its choice anywhere in the country and also, if it so decides, open as many FCRA utilization accounts in bank branches of its choice. The authorities of SBI, Main Branch, Sansad Marg, New Delhi shall transfer any foreign contribution received by any NGO/association to their other FCRA account or utilization account or both of them as per the choice/decision of that NGO/association. In the background, the Ministry of Home Affairs, Government of India has issued a FCRA Charter for Banks wherein, the Ministry has advised banks to go through all the provisions of the amended FCRA 2010 as well as amended Rules thereunder. Similarly, a charter was issued to Chartered Accountants advising them to get themselves thoroughly familiarised with the FCRA, 2010.

Decriminalisation of the Limited Liability Partnership Act, 2008 – Company Law Committee Report: A Company Law Committee was constituted by the MCA in September, 2019, *inter alia*, to study the existing framework under the Limited Liability Partnership Act, 2008 and to suggest measures to plug the gaps and to identify specific provisions and to decriminalize the provisions of the Limited Liability Partnership Act, 2008 based on their gravity and to take other concomitant measures to bring about greater ease of living for corporate stakeholders. The Committee has submitted its report to MCA on 4 January 2021. In the report, the Committee has recommended twelve offences to be decriminalized and to be shifted to In-house Adjudication Mechanism and two offences to be omitted. The Committee has prescribed a new class of LLP called 'Small LLP' in line with the concept of 'Small Companies' under the Companies Act, 2013. The Committee has recommended the insertion of enabling

provisions for permitting LLPs to issue non-convertible debentures to entities regulated by the SEBI or RBI. It has also recommended the definition of debenture as a non-convertible debenture issued by a limited liability partnership evidencing a debt constituting a charge on the assets of the limited liability partnership.

Fast track merger of startups – Companies (Compromises, Arrangements and Amalgamations) Rules, 2016: For fast track merger under Section 233 of Companies Act, 2013, the Central Government has prescribed:

i) two or more start-up companies; or
ii) one or more start-up company with one or more small company

as class of companies eligible for fast track merger.

A 'start-up company', according to the Companies (Compromises, Arrangements and Amalgamations) Amendment Rules, 2021, dated 1 February 2021, means a private company incorporated under the Companies Act, 2013 or Companies Act, 1956 and recognised as such in accordance with Notification number G.S.R. 127 (E), dated the 19 February 2019 issued by the Department for Promotion of Industry and Internal Trade.

Distinct transactions – Maharashtra Stamp (Amendment and Validation) Ordinance, 2021: Section 5 of the Maharashtra Stamp Act provides that any instrument comprising or relating to several distinct matters shall be chargeable with the aggregate amount of the duties with which separate instruments, each comprising or relating to one of such matters, would be chargeable under that Act. In order to bring clarity in the provisions of said Section 5 about charging stamp duty in respect of any instrument comprising or relating to several distinct transactions, the Section 5 of the Maharashtra Stamp Act has now been amended by the Maharashtra Stamp (Amendment and Validation) Ordinance, 2021, dated 9 February 2021 to specifically include 'distinct transactions'. The Section 5 will now be read as follows: '*Any instrument comprising or relating to several distinct matters or transactions shall be chargeable with the aggregate amount of the duties with which separate instruments, each comprising or relating to one of such matters or transactions, would be chargeable under this Act*.' It may be noted that Gujarat Stamp Act, 1958, as amended in the year 2007, covers instrument comprising of or relating to distinct transactions also as held by the Supreme Court in its judgement dated the 11 August 2015 in Civil Appeal No. 6054 of 2015. The Bombay High Court, while interpreting Section 5 of the Maharashtra Stamp Act, in Writ Petition No. 8014 of 2019, *vide* its Order dated the 11 September 2019, had held that the phrase 'distinct matters' appearing therein is equivalent to the phrase 'distinct transactions'.

Corporate Social Responsibility ('CSR') Policy – Rules amended: MCA *vide* its Notification dated 22 January 2021 has issued the Companies (Corporate Social Responsibility Policy) Amendment Rules, 2021 thereby significantly amending the Companies (Corporate Social Responsibility Policy) Rules, 2014. The amendment specifically defines the term 'Ongoing Project' as a multi-year project undertaken by a Company in fulfilment of its CSR obligation having timelines not exceeding three years excluding the financial year in which it was commenced, and shall include such project that was initially not approved as a multi-year project but whose duration has been extended beyond one year by the board based on reasonable justification. Rule 4 has been amended to clarify that a CSR activity can be carried out through a company established under Section 8 of the Companies Act, or a registered public trust or a

registered society, registered under Sections 12A and 80G of the Income Tax Act, 1961, established by the company, either singly or along with any other company. The earlier requirement specified only trusts with no specific reference to Sections 12A and 80G. A new form CSR-1 has been introduced for registration of every entity undertaking any CSR activity with the Central Government with effect from the 1 April 2021. However, it shall not affect the CSR projects or programmes approved prior to 1 April 2021. Form CSR-1 shall be signed and submitted electronically by the entity and shall be verified digitally by a Chartered Accountant or a Company Secretary or a Cost Accountant, in practice. On the submission of the Form CSR-1 on the portal, a unique CSR Registration Number shall be generated by the system automatically.

Going forward, the board of a company shall satisfy itself that the funds so disbursed have been utilised for the purposes and in the manner as approved by it and the Chief Financial Officer or the person responsible for financial management shall certify to the effect. The amendments now define administrative overheads as the expenses incurred by the company for 'general management and administration' of CSR functions in the company but shall not include the expenses directly incurred for the designing, implementation, monitoring, and evaluation of a particular CSR project or programme. The administrative overheads shall not exceed five percent of total CSR expenditure of the company for the financial year. Any surplus arising out of the CSR activities shall not form part of the business profit of a company and shall be ploughed back into the same project or shall be transferred to the Unspent CSR Account and spent in pursuance of CSR policy and annual action plan of the company or transfer such surplus amount to a Fund specified in Schedule VII, within a period of six months of the expiry of the financial year.

Ratio Decidendi

Insolvency – NCLT cannot direct Operational Creditor to settle matter outside tribunal on the ground of 'small due amount'

The National Company Law Appellate Tribunal ('**NCLAT**') has held that the Adjudicating Authority (NCLT, Bengaluru Bench in the present case) cannot direct an operational creditor to settle the dispute outside the forum / tribunal only because the debt owed was 'mere INR 4.35 Lakhs'. The Adjudicating Authority was further directed to examine the application under Section 9 of the Insolvency and Bankruptcy Code, 2016 ('**Code**') and proceed for its admission in due observance of the Code.

Brief facts:

a. On failure to recover any money from the Corporate Debtor, the Operational Creditor was forced to file application under Section 9 of the Code seeking initiation of insolvency proceedings against the Corporate Debtor.

b. Considering that the Corporate Debtor didn't appear before the authority and as the amount involved in the dispute was 'mere Rs. 4.35 Lakhs', the Adjudicating Authority disposed-off the application stating that initiation of CIRP was not a solution and chances of recovery under the CIRP will be negligible for the Operational Creditor.

Submissions:

a. Aggrieved by the order of the Adjudicating Authority, the Appellant - Operational Creditor submitted that disposition of the application has left the Operational Creditor high and dry.

b. The Adjudicating Authority failed to observe the provisions of the Code and instead of admitting the application directed to settle the issue outside the Tribunal.

c. Corporate Debtor submitted that on merits it had a good case as there was a pre-existing dispute. Further, it was submitted that the claims were barred by limitation.

Decision:

a. The approach of the Adjudicating Authority was not consistent with the Code. In a case, where the Respondent failed to appear, the Adjudicating Authority would be required to consider whether the application under Section 9 of IBC is complete and if there is debt due and default as required by the law. If application is complete, it must be admitted.

b. The impugned order was set aside and the matter was remanded back to the NCLT to consider the application as per the provisions of the Code, after hearing the parties.

[*Aster Technologies Private Limited* v. *Solas Fire Safety Equipment Private Limited* – Order dated 5 January 2021 in Company Appeal (AT) (Insolvency) No. 916 of 2020, NCLAT]

Consumer protection – Incorporation of one-sided terms in Builder Buyer's Agreement constitutes an unfair trade practice

The three-judge bench of the Supreme Court of India has held that the terms of the Apartment Buyer's Agreement being oppressive and one sided, would constitute an unfair trade practice under extant consumer protection laws. It was held that the developers cannot compel the buyers to be bound by the one-sided contractual terms.

Brief facts:

a. The present Appellant (Developer), in possession of a license to develop a group housing colony ('**Project**') opened bookings for the apartments. The Respondent No. 1 was allotted an apartment in the Project. Similar allotment letters were issued to various other apartment buyers in the Project.

b. As the Developer failed to deliver the possession of the flats, various cases were lodged against it in different forums including the National Consumer Dispute Redressal Commission ('**NCDRC**') and Haryana Real Estate Regulatory Authority. The NCDRC held that since the Developer failed to deliver the possession of the allotted flats to the apartment buyers, it amounted to deficiency in services and the complainants were entitled to refund of the amount along with appropriate compensation.

c. It is pertinent to note here that the Haryana Real Estate Regulatory Authority after due perusal of the status of the Project and interest of the parties, passed an order that, '*refund cannot be allowed at this stage of the Project*'.

d. The present Appellant (Developer) approached the Supreme Court challenging the various orders passed by the NCDRC

which had directed it to refund the amount deposited by the apartment buyers.

Submissions by the Appellant Developer:

a. The period of 42 months for handing over possession of the flat would commence only after the conditions mentioned in the 'Building Plans' were fulfilled which *inter alia* included obtaining Fire NOC.

b. The finding recorded by the NCDRC that the clauses of the Apartment Buyer's Agreement ('**Agreement**') were one-sided and unfair was illegal and without jurisdiction.

c. Decision of RERA must be given primacy over the NCDRC. In view of the conflicting views (the calculation of date of delivery of possession) taken by the two Forums which exercise original jurisdiction, it is the order of RERA which ought to be upheld. Particularly, since RERA is a specialized fact-finding authority with respect to real estate projects, it is the special law which must prevail over the general law.

Submissions by the Respondent:

a. The 42 months period and the additional grace period as available to the Appellant Developer should be calculated from the date of approval of Building Plan and not from the date of receipt of necessary Fire NOC since the grant of Fire NOC was not a pre-condition for commencement of any construction work.

b. The Agreement contained one-sided clauses, which were not final and binding on the apartment buyers and would constitute an unfair trade practice under the extant consumer protection laws. Reliance was also placed on the judgment - *Pioneer Urban Land and Infrastructure Ltd.* v. *Govindan Raghavan*[2].

[2] (2019) 5 SCC 725

Decision:

a. Referring to Section 15 of the Haryana Fire Safety Act, 2009, clauses of the Agreement and the approved 'Building Plan', the Supreme Court held that the 42 month period would be required to computed from the date on which Fire NOC was issued and not from the date of the approval of the Building Plans.

b. Upon perusal of various clauses of the Agreement, the Court specified that the clauses therein were wholly one-sided, entirely loaded in favour of the Appellant - Developer, and against the allottee at every step. It was held that the terms of the Agreement were oppressive and would thus constitute an unfair trade practice under Section 2(1)(r) of the Consumer Protection Act, 1986.

c. Section 88 of the RERA Act, 2016 is akin to Section 3 of the Consumer Protection Act, 1986 and provides that the provisions of the RERA Act shall apply in addition to and not in derogation of other applicable laws. Further it was observed that, '*An allottee may elect or opt for one out of the remedies provided by law for redressal of its injury or grievance. An election of remedies arises when two concurrent remedies are available, and the aggrieved party chooses to exercise one, in which event he loses the right to simultaneously exercise the other for the same cause of action.*' Reliance was also placed on the judgment -*Imperia Structures Ltd.* v. *Anil Patni and Anr*[3].

d. While considering the question whether Apartment Buyers were entitled to terminate the Agreement and claim refund of the

[3] (2020) 10 SCC 783 - Summary can be accessed from L&S Corporate Amicus for December 2020, available here.

amounts deposited with interest, the Court held as follows:

(i) For apartment buyers falling under Category 1 (where the Apartment Buyers were granted Occupancy Certificate and offer of possession has been appropriately made), the allottees shall be given the possession of the flats. However, the Appellant-Developer shall be under an obligation to pay compensation for the period of delay.

(ii) For Category 2 (where the Occupancy Certificate was not granted), the Appellant shall be responsible to refund the entire amount so deposited by the allottees, along with appropriate compensation and interest.

[*Ireo Grace Realtech Pvt. Ltd.* v. *Abhishek Khanna and Ors.* – Judgment dated 11 January 2021 in Civil Appeal No. 5785 of 2019, Supreme Court of India]

Arbitration – Validity of arbitration clause in an unstamped commercial contract – Matter referred to 5-Judge Bench of Supreme Court

The three-judge bench of the Supreme Court of India has held that non-payment of stamp duty in a commercial contract does not invalidate the arbitration clause mentioned therein. However, due to the conflict with the earlier Supreme Court judgment, the matter was referred to a larger bench.

Brief facts:

a. M/s. Indo Unique Flame Limited (Respondent) entered into a sub-contract with the present Appellant – M/s. N.N. Global Mercantile Private Limited for transportation of coal from its washery to the stockyard, siding, coal handling and loading of coal into wagons. As per the work order, the Appellant also submitted a bank guarantee ('**Bank Guarantee**') for Rs. 3,36,00,000/- in favour of SBI – banker for the Respondent.

b. Due to invocation of another bank guarantee by the principal contractor which was furnished by the Respondent, the Respondent invoked the Bank Guarantee furnished by the Appellant under the work order.

c. The Appellant filed a civil suit against the invocation of Bank Guarantee. Further, since the sub-contract contained an arbitration clause, the Respondent filed an application under Section 8 of the Arbitration & Conciliation Act, 1996 ('**Arbitration Act**') seeking reference to arbitration, which was rejected. Aggrieved by the same, the Respondent challenged the order of the commercial court in the Bombay High Court ('**High Court**') which set aside the order of the commercial court. Aggrieved by the judgment of the High Court, the Appellant filed Special Leave Petition with the Supreme Court.

Submissions:

a. The appellant contended that the application made under Section 8 of the Arbitration Act was not maintainable, since as per Section 34 of the Maharashtra Stamp Act, 1958 the work-order being an unstamped document, could not be received in evidence for any purpose, or acted upon, unless it is duly stamped. Consequently, the arbitration clause in the unstamped agreement also could not be acted upon or enforced since the arbitration clause would have no existence in law, unless the applicable stamp duty (and penalty, if any) is paid.

b. Since there was no invoice raised or work done which resulted in absence of any legal liability for any sort or payment, the act of invoking the Bank Guarantee was fraudulent because the agreement was never worked upon.

c. The respondents submitted that even though the work-order was an unstamped agreement, it would be enforceable after it is duly stamped, for which an opportunity must be given to the parties to make up the deficient stamp duty and penalty as may be assessed by the Collector of Stamps. Non-payment of stamp duty would not render the agreement unenforceable as it is a curable defect.

Decision:

a. On the basis of the doctrine of separability, the arbitration agreement being a separate and distinct agreement from the underlying commercial contract, would survive independent of the substantive contract. The arbitration agreement would not be rendered invalid, un-enforceable or non-existent, even if the substantive contract is not admissible in evidence or cannot be acted upon on account of non-payment of stamp duty.

b. The Supreme Court also held that that the findings of the same court in *SMS Tea Estates*[4] and *Garware Wall Ropes Limited*[5] that non-payment of stamp duty on the commercial contract would invalidate even the arbitration agreement, and render it non-existent in law and unenforceable, were not the correct position in law. As the findings in *Garware Wall Ropes Limited* case was affirmed in the case of *Vidya Drolia*[6] (three-judge Bench), the matter was referred to a five-judge Bench. The question as referred to the larger bench was:

'Whether the statutory bar contained in Section 35 of the Indian Stamp Act, 1899 applicable to instruments chargeable to Stamp Duty under Section 3 read with the Schedule to the Act, would also render the arbitration agreement contained in such an instrument, which is not chargeable to payment of stamp duty, as being non-existent, unenforceable, or invalid, pending payment of stamp duty on the substantive contract / instrument?'

c. The Court made a distinction between cases where there are allegations of serious fraud and fraud *simplicitor*. It held that mere allegations of fraud *simplicitor* are not a sufficient ground to decline reference to arbitration. Thus, the civil aspect of fraud can be adjudicated by an arbitral tribunal.

d. The Court also held that, '*since both parties have admitted the existence of the arbitration agreement between the parties, as recorded in the judgment of the High Court, and even before this Court during oral submissions, parties may either appoint a sole arbitrator consensually; failing which, an application under Section 11 for the appointment of the arbitrator may be made before the High Court*.'

[*N.N. Global Mercantile Pvt. Ltd.* v. *Indo Unique Flame Ltd. & Others* – Judgment dated 11 January 2021 in Civil Appeal No. 3802-3803 of 2020, Supreme Court of India]

Insider trading – SEBI Order in the matter of trading activities in scrip of Future Retail Limited

The Whole Time Member of SEBI has passed an order ('**Order**') *inter alia* restraining Mr. Kishore Biyani, Mr. Anil Biyani and others from accessing the securities market for a period of one year from the date of the said Order and to disgorge the wrongful gains with interest for violation of the Securities and Exchange Board of India Act, 1992 ('**SEBI Act**') read with the SEBI (Prohibition of Insider Trading) Regulations, 2015 (**'PIT Regulations'**).

[4] (2011) 14 SCC 66
[5] (2019) 9 SCC 209
[6] C.A. No. 2402 of 2019, delivered on 14 December 2020

Brief facts:

a. SEBI issued SCNs in the month of January 2020 to Future Corporate Resources Private Limited (earlier known as Future Corporate Resource Limited - '**FCRL**'), Mr. Kishore Biyani, Mr. Anil Biyani, FCRL Employee Welfare Trust ('**FCRLEWT**') and 4 others (Compliance Officer, Company Secretary, etc.), collectively referred as '**Noticees**', for violation of PIT Regulations in relation to trading in shares of Future Retail Limited ('**FRL**') in the year 2017.

b. FRL made an announcement related to one of the 'Composite Scheme of Arrangement' on April 20, 2017 to the exchange. The scheme of arrangement resulted in demerger of certain businesses (HomeTown and FabFurnish) of FRL, which had a positive impact on the price of the shares of FRL to an extent of 4.68% during the market hours. This information was considered as Unpublished Price Sensitive Information ('**UPSI**') in accordance with the PIT Regulations. This UPSI came into existence on March 10, 2017 itself as 'preliminary discussions'.

c. Mr. Kishore Biyani along with Mr. Anil Biyani took the decision to trade in the shares of FRL through FCRL and made notional unlawful gain to the tune of 17,78,25,000/-. Further Noticee No. 5 and 6 as mentioned in the Order traded in the shares of FRL through FCRLEWT. These trades were made after 10 March 2017 but before the disclosure date of information to the exchange of the demerger, i.e. during the period of having UPSI ('**UPSI Period**'). Further Noticee No. 7, being the Compliance Officer failed to perform his duties of giving 'closure of trading window' notice and giving pre-clearance of such trade to FCRL. Noticee No. 8, being deputy manager with FRL and part of email communications, also traded in the shares of FRL during the UPSI Period. On the basis of relevant investigations conducted by SEBI, SCNs were then issued to the Noticees to show cause why they should not be held liable under the SEBI Act and PIT Regulations.

Submissions by the Noticees:

a. The information in relation to the scheme of arrangement was 'generally available' and does not constitute UPSI.

b. Information of the scheme was not price sensitive, even if it is assumed that such information was not 'generally available'. It was submitted that various industry wide factors (such as demonetisation, Goods and Services Tax, D-Mart IPO) and various equity research houses' reports significantly contributed to the price movement in the shares of FRL. Further, the proposed scheme of arrangement resulting in demerger of certain business undertaking constituted only a small portion of FRL's overall business, which could not have impacted the price movement.

c. Certain Noticees were not aware of the scheme of arrangement and traded directly or indirectly, as the case be, on *bona fide* instructions.

Observation by SEBI:

a. The limited information that was available in the public domain in relation to the proposed scheme of arrangement was very fluid and nebulous. Thus, the disclosure made to the exchange on 20 April 2017 was the first disclosure of the UPSI to the exchanges and the UPSI Period started from 10 March 2017 itself. The information was not 'generally available' and constituted a UPSI.

b. The corporate announcement had its own appreciable impact on the price of the shares

of FRL and therefore, the information was price sensitive.

c. Noticee 2 and 3 traded in the shares of FRL through Noticee 1 and Noticee 5 and 6 traded in the same share through Noticee 4, being in possession of UPSI. It was observed that an insider when in possession of UPSI has traded in the securities then it is a natural inference that such trades were on the basis of the UPSI. Thus, there was a clear violation of the PIT Regulations.

Directions passed:

With due regard to the PIT Regulations and the penal provisions of the SEBI Act, SEBI in its directions *inter alia* provided that,

a. FCRL and Noticee No. 2, 3, 5, 6 and 8 shall be restrained from accessing the securities market and further prohibited from buying, selling or otherwise dealing in securities, directly or indirectly, or being associated with the securities market in any manner, whatsoever, for a period of one (1) year, from the date of the said Order.

b. FCRL and Noticee No. 2 and 3 were also directed to jointly and severally disgorge the wrongful gain of Rs. 17,78,25,000/- along with an interest at the rate of 12% per annum from April 20, 2020 till the date of actual payment.

It is relevant to note here that SEBI in its Order also provided that, *'Debarment/restraint/freeze imposed under this order shall not apply to those existing holding of securities of such debarred entities, in respect of which any scheme of arrangement under Section 230-232 of the Companies Act, 2013, is approved by NCLT, requiring extinguishment of such securities and/or receipt of other securities in lieu of such securities.'* Thus, the Order might not affect the ongoing Reliance - Future Group deal as well. Moreover, Mr. Kishore Biyani has also moved the Securities Appellate Tribunal against the said SEBI Order as per news available in the public domain.

[Final Order in the matter of *Future Retail Limited* – Whole Time Member Order dated 3 February 2021, Securities and Exchange Board of India]

News Nuggets

Insolvency – IBC Section 10A suspends initiation of CIRP for defaults occurring after 25 March 2020 even though application is filed before 5 June 2020: Supreme Court

The Supreme Court of India has rejected the contention that the provisions of Section 10A of the Insolvency and Bankruptcy Act, 20216 (suspending the initiation of Corporate Insolvency Resolution Process) are not attracted to an application under Section 9 which was filed before 5 June 2020 (the date on which Section 10A came into force) in respect of a default which has occurred after 25 March 2020. Reading the Section 10A along with the proviso, the Court held that the

Parliament intended to impose a bar on the filing of applications for the commencement of the CIRP in respect of a corporate debtor for a default occurring on or after 25 March 2020. It was of the view that otherwise, it would defeat the very purpose and object underlying the insertion of the said section. The Apex Court in the case *Ramesh Kymal* v. *Siemens Gamesa Renewable Power Pvt. Ltd.* [Decision dated 9 February 2021] held that the correct interpretation of Section 10A cannot be merely based on the language of the provision, rather it must take into account the object of the Ordinance and the extraordinary circumstances in which it was promulgated. The submission that the expression 'shall be filed' is indicative of a legislative intent to make the provision prospective so as to apply only to those applications which were filed after 5 June 2020 when the provision was inserted, was found not acceptable.

No TDS on sale of assets by liquidator – Section 53 of IBC to have overriding effect on Section 194-IA of Income Tax Act

In an interesting dispute involving interface of income tax and the insolvency provisions, the NCLAT has held that Section 53(1)(e) of the Insolvency and Bankruptcy Code, 2016 shall have overriding effect on the provisions of the Section 194-IA of the Income Tax Act, 1961. The Appellate Tribunal noted that with regard to the recovery of Government dues (including income tax) from the company in liquidation under IBC, there is inconsistency between Section 194-IA of the IT Act and Section 53(1)(e) of the Code because as per Section 194-IA, 1% TDS is to be recovered on priority to other creditors of the transferor, whereas, Section 53(1)(e) provides that the Government dues comes fifth in order of priority. Setting aside the NCLT Order, the NCLAT in the case *Om Prakash Agrawal* v. *Chief Commissioner* [Judgement dated 8 February 2021] observed that adjudicating Authority had erroneously held that the deduction of tax at source does not mean raising demand for collection of tax by the Department.

Resolution plan is sacrosanct – Amount recovered before SCN to form part of principal dues

Observing that the resolution plan approved by the Committee of Creditors and further approved/sanctioned by the adjudicating authority (NCLT) was binding on all creditors including the Central Government, the Bombay High Court has rejected the contention of the Revenue department that the amount already recovered should be allowed to be appropriated. It noted that as per the approved resolution plan, the assessee was required to pay 5% of the 'adjudicated' dues and not 'adjusted' dues, as contented by the Revenue. The department was directed to retain only 5% (of the principal dues) from the amount recovered and refund the balance to the assessee. [GGS INFRASTRUCTURE PVT LTD. v. Commissioner - 2020-TIOL-2227-HC-MUM-ST]

Insolvency – Creditor when not a 'financial creditor'

The 3-Judge Bench of the Supreme Court has held that if a corporate debtor only gives security by pledging shares, without undertaking to discharge borrower's liability, the creditor does not become a 'financial creditor' within the meaning of the term as defined under the provisions of the Insolvency and Bankruptcy Code, 2016. The Court was of the view that the Pledge Agreement and Agreement of Undertaking executed subsequent to the Facility Agreement, was security in favour of Lender-Assignor, who at best will be a secured creditor *qua* the corporate

debtor and not the 'financial creditor' *qua* corporate debtor. The plea that the corporate debtor was the direct and real beneficiary of the loan advanced by the Assigner to the parent company of the corporate debtor and hence the judgment of the Apex Court in *Jaypee Infratech Limited* was not applicable, was thus rejected by the Court in the case of *Phoenix Arc Pvt. Ltd.* v. *Ketulbhai Ramubhai Patel* [Judgement dated 3 February 2021].

Pre-packaged insolvency under IBC

A sub-committee of the Insolvency Law Committee to recommend a regulatory framework for pre-pack insolvency resolution process was constituted *vide* Office Order No. 30/20/2020, dated 24 July 2020. The sub-committee has designed a pre-pack framework within the basic structure of the Insolvency and Bankruptcy Code, 2016 for the Indian market as detailed in their report of October 2020. *Vide* notice dated 8 January 2021, the report of the Committee was released to the public for their comments.

Scheme for condonation of delay for companies restored in Register of Companies in December 2020

The MCA, *vide* General Circular 03/2021 has provided a scheme for condonation of delay (in overdue filings before the Registrar) for companies restored between 1 December 2020 and 31 December 2020 under Section 252 of the Companies Act, 2013. Under the Scheme, the last date for filing any overdue e-forms by such companies shall be 31 March 2021. Every company shall be required to pay normal filing fees under the Companies (Registration Offices and Fees) Rules, 2014 on the date of filing and no additional fees shall be payable for the forms for which the scheme is applicable. The Scheme is applicable for all e-forms, except SH-7 and CHG-1, 4, 8 and 9.

Master Circular on Depositories issued by SEBI

SEBI *vide* Circular SEBI/HO/MRD2/DDAP/CIR/P/2021/18, dated 5 February 2021 has issued a Master Circular on depositories in order to enable the users to have access to all the applicable circulars/directions at one place. The Master Circular is a compilation of the relevant circulars/communications pertaining to Depositories issued by SEBI up to 31 October 2020 and has come into force from the date of its issue. The Master Circular consists of four sections i.e. Beneficial Owner (BO) Accounts, Depository Participants (DP) related, Issuer related and Depositories related.

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