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Anti-Dilution – Balancing the ills of a Down Round

By **Shipra Verma**

Anti-dilution rights are the most common armour provided to investors against a down round funding raised by any company. These can be exercised in two ways - the first being full ratchet anti-dilution protection while the second is weighted average method of computation. The article in this issue of Corporate Amicus discusses both the ways at length along with illustrations, etc. It also analyses for this purpose pricing guidelines set forth in the Foreign Exchange Management (Non-Debt) Instruments Rules, 2019 and possible routes out of the hurdle caused by the Rules. According to the author, negotiations of anti-dilution clauses must consider all intricacies, advantages and limitations of the concept, firstly to ensure that the interests of the investors remain protected and secondly to see that the down-round does not become burdensome to the promoters or other shareholders.

Anti-Dilution – Balancing the ills of a Down Round

By Shipra Verma

Any investment by a Venture Capital ('**VC**') or Private Equity ('**PE**') investor is made with the hope of seeing sizeable returns as the business of the investee company grows over years. However, if the situation turns, a decreased valuation will reduce worth of the VC or PE investor's stake in the company, resulting in significant loss to the investor.

A steep decline in valuation can result from a multitude of reasons that range from stagnant growth of business and revenues to governance issues, to increased costs of debt and repayment obligations, to a dwindling reputation of company or its management.

Anti-dilution rights are the most common armour provided to investors against a down round funding raised by any company. These can be exercised in two ways - the first being full ratchet anti-dilution protection while the second is weighted average method of computation.

Full Ratchet Protection:

A full ratchet anti-dilution right provides absolute protection to an investor by revaluing their original investment at the price offered by the company in such down round and accordingly increasing the number of shares that they hold in the company on a fully diluted basis.

Let us assume that an investor invests in a total amount of USD 1,000,000 in a company for 1000 convertible preference shares at the price of USD 1000 per share and negotiates a full ratchet price protection right. If, in a subsequent down round, the said company issues its shares at the lower price of USD 500 per share, it will be assumed that the original investment was made at this reduced price, and the original investor in question will be entitled to further 1000 shares in the Company.

While most advantageous to any investor, full ratchet right is also the most uncommon in general practice, purely because of being unfair to the promoters. It does ensure 'non-dilution' of the investor's interests and that they do not bear the brunt of a down round to any extent. However, it does so by causing inordinate dilution in the shareholding of promoters and other shareholders who may have not negotiated this right. A dilution of this character can lead to loss of control of the promoters over the company, with an external investor getting a majority of the

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shareholding. Successive down round investments coupled with a full ratchet anti-dilution right will invariably lead to transfer of a lion's share of ownership to new investors, making the company unappealing to other existing and prospective shareholders.

Weighted Average Protection:

A weighted average right follows a more equitable approach, taking into consideration both the price at which shares were initially issued to an investor and the price at which shares are being issued in the down round.

A weighted average right can either be broad-based or narrow-based. Broad-based computation takes into account all shares of the company on a fully diluted basis, meaning that all options, warrants or other convertible securities are deemed to have been converted into shares at the time of determination. In case of a narrow-based determination, as the name suggests, a narrower approach is taken with only those shares being considered that have actually been issued and allotted, while any unexercised options or warrants are disregarded.

The formula used for weighted average anti-dilution protection is:

$$NCP = OCP * (A+B) / (A+C)$$

where,

NCP is the new conversion price,

OCP is the original agreed conversion price,

A is the total number of shares immediately prior to the down round,

B is the number of shares that would have been issued in the new round had it been raised at the valuation of the original round; and

C is the number of shares being issued in the down round.

Let us assume that: (i) an investor ('**Investor 1**') has invested USD 1,000,000 in a company and is allotted 1000 convertible preference shares at the price of USD 1000 per share, with a conversion price of USD 1000, and (ii) after the investment, the cap-table of the company, on a fully diluted basis, is as follows:

Shareholders	**Number of Shares**	**Percentage of Shareholding**
Promoter 1	4500	45%
Promoter 2	4500	45%
Investor 1	1000	10%
Total	**10,000**	**100%**

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Thereafter, in a subsequent down round, a new investor ('**Investor 2**') also invests USD 1,000,000 and is allotted 2000 shares at a lesser price per share of USD 500. The cap-table of the company (on a fully diluted basis) without any anti-dilution protection to Investor 1 will be as below:

Shareholders	**Number of Shares**	**Percentage of Shareholding**
Promoter 1	4500	37.5%
Promoter 2	4500	37.5%
Investor 1	1000	8.3%
Investor 2	2000	16.7%
Total	**12,000**	**1000%**

If, however, Investor 1 has weighted average anti-dilution protection, a new conversion price will be computed for the convertible preference shares held by it. The computation (basis the above formula) will be as follows:

OCP = USD 1000

A = 10000

B = 1000

C = 2000

NCP = 1000 * (10000+1000)/(10000+2000) = 916.7

In this instance, Investor 1 will be entitled to convert its convertible preference shares at the new conversion price and acquire a few additional shares. The number of additional shares to be allotted to it will be:

USD 1,000,000 / USD 916.7 = 1,091

The cap-table of the company on a fully diluted basis, in light of the new conversion price will be:

Shareholders	**Number of Shares**	**Percentage of Shareholding**
Promoter 1	4500	37.2%
Promoter 2	4500	37.2%
Investor 1	1091	9.02%
Investor 2	2000	16.54%
Total	**12,091**	**1000%**

As is evident from above, with weighted average anti-dilution right, the magnitude a down round's impact on Investor 1 will reduce, without causing excessive dilution in shareholding of promoters and other shareholders.

Implementation of Anti-Dilution Rights:

The customary way of enforcing an anti-dilution right is adjustment of conversion price and issue of additional shares accordingly.

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The single largest hurdle in this implementation may occur due to the pricing guidelines set forth in the Foreign Exchange Management (Non-Debt) Instruments Rules, 2019 ('**NDI Rules**').

These rules require that issue of shares of a private limited company to a non-resident shareholder cannot be at a price less than fair market value determined as per any internationally accepted pricing methodology for valuation on an arm's length basis duly certified by a chartered accountant or a merchant banker registered with the Securities and Exchange Board of India or a practising cost accountant. Further, as per Rule 21 of the NDI Rules, conversion of any convertible equity instrument must not be at a price less than the fair market value determined at the time of issue of such instruments (as stated above).

The above requirement makes it impossible to issue shares free of cost to any non-resident investor in exercise of their anti-dilution right. Similarly, exercising an adjusted conversion price which is less than the fair market value at the time of issue of equity instruments is also prohibited.

To address this concern, it is suggested that the issue price of equity instruments for any non-resident investor be over and above the fair market value determined in compliance with the pricing guidelines. This will ensure that there exists a cushion between issue price and fair market value that can absorb any downward adjustment of conversion price.

Another way out can be primary issue or secondary transfer of shares by founders to a resident nominee of the non-resident investor at minimum permissible prices, who will hold the shares and exercise its rights over them as per instructions of the concerned foreign investor. This, however, will be useful only if the non-resident investor can identify such a nominee resident in India.

Conclusion

Anti-dilution rights are critical for creating an investor's confidence in the company where it intends to make investment. At the same time, anti-dilution rights should not be structured in a way that protects interest of a single investor at the cost of interest held by founders or other shareholders in the Company. An unbalanced right will demotivate existing shareholders as well as become a handicap in future rounds of investment. Company and promoters may, with respect to the same, negotiate a pay-for-play provision that entitle an investor to ant-dilution rights so long as they continue to participate in future rounds of funding raised by the Company. Alternatively, a sunset provision may be agreed to, with anti-dilution rights being provided only for first few rounds of investment and once

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the company has reached a pre-agreed valuation threshold, the right can cease to be of any effect.

Negotiations of anti-dilution clauses must consider all intricacies, advantages and limitations of the concept. Impact of all subtle changes introduced in the clause should also be analysed by the parties. A comprehensive understanding of the provision and a methodical clause drafted accordingly will ensure that in an event of a down-round, interests of investors remain protected, do not become burdensome to the promoters or other shareholders and are enforced without any unwarranted complications.

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Notifications & Circulars

- E-adjudication platform introduced – Companies (Adjudication of Penalties) Rules, 2014 amended
- Companies (Registration of Foreign Companies) Amendment Rules, 2014 amended
- Limited Liability Partnership Rules, 2009 amended
- Foreign Exchange Management (Non-debt Instruments) Rules, 2019 amended
- Master Directions on Cyber Resilience and Digital Payment Security Controls for non-bank Payment System Operators issued
- Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018 – Third amendment of 2024
- SEBI (Mutual Funds) Regulations, 1996 – Second amendment of 2024
- Additional disclosures by FPIs – SEBI Circular revised to exempt University Funds and University-related Endowments
- SEBI (Alternative Investment Funds) Regulations, 2012 amended
- Valuation of Additional Tier 1 Bonds (AT-1 Bonds) by Mutual Funds
- Master Circular for Real Estate Investment Trusts (REITs) amended
- Master Circular for Infrastructure Investment Trusts (InvITs) amended
- SEBI issues modalities for migration of Venture Capital Funds

E-adjudication platform introduced – Companies (Adjudication of Penalties) Rules, 2014 amended

The Ministry of Corporate Affairs *vide* Notification G.S.R. 476(E), dated 5 August 2024, has amended the Companies (Adjudication of Penalties) Rules, 2014, to streamline the adjudication process, enhancing transparency and efficiency through the mandatory use of digital platforms for all proceedings. The key amendments include:

1. *Electronic Adjudication Platform* - From 16 September 2024, all adjudication proceedings, including notice issuance, document filing, hearings, and penalty payments, must be conducted electronically through the Central Government's e-adjudication platform. If the email address of any person to whom notice/summons is required to be issued is unavailable, the notices will be sent by post and preserved electronically.

2. *Revised Appeal Form (Form No. ADJ)* - The amendment introduces a new Annexure with a revised Form No. ADJ for appealing penalty orders. The form includes sections for detailed case particulars, grounds for appeal, and relief sought. Appeals are required to be filed electronically, with required attachments like certified copies of the penalty order and authorization letters, wherever applicable.

Companies (Registration of Foreign Companies) Amendment Rules, 2014 amended

The Ministry of Corporate Affairs *vide* Notification G.S.R. 491(E), dated 12 August 2024, notified certain amendments to the Companies (Registration of Foreign Companies) Rules, 2014. The amendments modify sub-rule (3) of Rule 3, substituting the term 'registrar' with 'Registrar, Central Registration Centre'. Additionally, in sub-rule (1) of Rule 8, a new proviso has been inserted, specifying that the documents required for the registration of a foreign company under sub-rule (3) of Rule 3 must be delivered in Form FC-1 to the Registrar, Central Registration Centre. According to this notification, the amendments shall come into effect from 9 September 2024.

Limited Liability Partnership Rules, 2009 amended

The Ministry of Corporate Affairs *vide* Notification No. G.S.R. 475(E), dated 5 August 2024, has notified certain amendments to the Limited Liability Partnership Rules, 2009, under Rule 37. The amendments incorporate the words 'Centre for Processing Accelerated Corporate Exit' ('**C-PACE**'), alongside the 'Registrar', to handle processes related to the accelerated exit of

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limited liability partnerships. C-PACE, established by the Central Government, aims to alleviate the pressure on the Registry, enhance its accuracy, and ensure a higher quality of data for stakeholders. In light of the same, the amendments add references to C-PACE in sub-rules (1), (3), and (4) of Rule 37, to ensure that either the Registrar or C-PACE, as applicable, will oversee corporate exit procedures, thus streamlining and expediting the exit process available for limited liability partnerships. The amendments come into effect from 27 August 2024.

Foreign Exchange Management (Non-debt Instruments) Rules, 2019 amended

The Department of Economic Affairs, Ministry of Finance *vide* Notification S.O. 3492(E), dated 16 August 2024, has introduced amendments to the Foreign Exchange Management (Non-debt Instruments) Rules, 2019. It includes the definition of 'control' for companies and LLPs, aligning it with the Companies Act, 2013, under Rule 2, in clause (da). It also updates the definition of a 'startup company' to match the criteria set by the Government of India in 2019, under clause (an). Additionally, the amendment notifies the requirement of prior government approval for transfers involving equity instruments in cases where such approval is necessary, under clause (1) of Rule 9.

New provisions have been introduced making amendments to Rule 23, Schedule I, Schedule II and Schedule VII, to allow the swap of equity instruments and foreign equity capital between residents and non-residents, subject to compliance with specified rules. The amended Rules clarify that investments by Indian entities owned by NRIs or OCIs on a non-repatriation basis are not deemed indirect foreign investments. They allow Indian companies to issue equity instruments to non-residents through equity swaps and capital goods imports. The Amendment sets a 100% sectoral cap for foreign investments in White Label ATM Operations (WLAO), requiring a minimum net worth of ₹100 crore. It also treats Foreign Portfolio Investors with over 50% common ownership or control as a single investor group, affecting regulatory treatment. Additionally, equity and debt investments in Indian startup companies are allowed across all sectors, subject to sectoral caps and conditions.

Master Directions on Cyber Resilience and Digital Payment Security Controls for non-bank Payment System Operators issued

The Reserve Bank of India *vide* Direction No. RBI/DPSS/2024-25/123 CO.DPSS.OVRST. No.S447/06-26-002/2024-25, dated 30 July 2024, has issued Master Directions on Cyber Resilience and Digital Payment Security Controls for non-bank Payment

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System Operators ('**PSOs**') to enhance the security of payment systems. The key aspects of the same include:

1. PSOs must have a Board-approved Information Security policy, with oversight on cyber risks, and a Cyber Crisis Management Plan (CCMP).
2. They must have baseline Security Measures, which include-
   - *Inventory Management* - PSOs must maintain a record of key information assets and ensure risk assessment for assets reaching the end of life.
   - *Identity and Access Management* - Policies must ensure secure access, with digital identities for all IT environment users and robust controls for privileged accounts.
   - *Network Security* - PSOs should implement multi-layered defences, maintain a Security Operations Centre

Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018 – Third amendment of 2024

The Securities and Exchange Board of India has *vide* Notification No. SEBI/LAD-NRO/GN/2024/196, dated 29 July 2024, notified certain amendments to the Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018. Given below is a list of the key amendments made through this notification.

1. *Regulation 21* - Sub-regulation (1) of Regulation 21 has been revised to require recognized stock exchanges and clearing corporations to disclose their shareholding pattern, quarterly, on their respective websites. The format and requirements for this disclosure shall be aligned with the provisions specified for listed companies under the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.
2. *Regulation 29* - In sub-regulation (2), clause (a) of Regulation 29, the reference to the 'Core Settlement Guarantee Fund' has been removed.
3. *Schedule I* - Paragraph 27 in Part III of Annexure to Form A has been omitted and therefore the clearing corporation need not mention details regarding any rules that provide for the direct election by clearing members on the Advisory Committee of the governing board.
4. *Schedule II* - In Paragraph (1) of Part G, the reference to Sub-regulation (10) of Regulation 19 has been removed, and the

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phrase 'Board circular dated January 01, 2016' in clause (c) has been replaced with 'guidelines as specified by the Board from time to time', which implies that the listed stock exchanges would be guided by the guidelines as specified by the Board from time to time for monitoring of shareholding limits. Additionally, Paragraph V of Part H dealing with the provision for 'Selection of trading/clearing members on the Advisory Committee to the governing board' under this Schedule has been omitted.

SEBI (Mutual Funds) Regulations, 1996 – Second amendment of 2024

The Securities and Exchange Board of India *vide* Notification No. SEBI/LAD-NRO/GN/2024/197, dated 1 August 2024, has notified certain amendments to the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996. In sub-regulation (1) of Regulation 2, after clause (na), it introduces the term 'market abuse,' which now explicitly covers manipulative, fraudulent, and unfair trade practices that violate relevant sections of the SEBI Act and associated regulations on fraudulent practices and insider trading. Additionally, under Regulation 25, after sub-regulation (26), the amendment inserts sub-regulations (27), (28), and (29) which include measures to combat such market abuse. Asset Management Companies ('**AMCs**') shall now be required to establish institutional mechanisms to identify and deter potential abuse, including front-running and fraudulent transactions and the responsibility for implementation of the same shall fall on the CEO, Managing Director, or any other person of equivalent rank. Additionally, AMCs shall adopt a comprehensive whistleblower policy for reporting concerns related to fraudulent or unethical practices. Furthermore, under sub-clause (b) of clause 2 in Part B under the Fifth Schedule, a proviso is included stating that face-to-face communications of dealers and fund managers, including out-of-office interactions, may not need to be recorded. These amendments aim to bolster the regulatory framework for mutual funds by promoting transparency, accountability, and the prevention of market abuse.

Additional disclosures by FPIs – SEBI Circular revised to exempt University Funds and University-related Endowments

The Securities and Exchange Board of India *vide* Circular SEBI/HO/AFD/AFD-POD-2/P/CIR/2024/104, dated 1 August 2024, has introduced the amendments to the Master Circular for Foreign Portfolio Investors ('**FPIs**') concerning additional disclosure requirements. The initial circular from 24 August 2023, required FPIs to meet criteria to provide additional

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disclosures. However, FPIs meeting specific conditions listed under Para. 8 were exempted from these requirements. SEBI has now decided that University Funds and University-related Endowments, which are registered or eligible to be registered as Category-I FPIs, shall also be exempt from these additional disclosure requirements under the following conditions:

1. Indian equity AUM must be less than 25% of global AUM.
2. Global AUM must exceed INR 10,000 crore.
3. The entity must provide appropriate returns/filings to tax authorities in their home jurisdiction, proving their non-profit status and tax exemption.

SEBI (Alternative Investment Funds) Regulations, 2012 amended

The Securities and Exchange Board of India *vide* Notification No. SEBI/LAD-NRO/GN/2024/198, dated 5 August 2024 has notified amendments to the Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012. Under sub-regulation (3) of Regulation 4, it omits the words 'to meet day-to-day operational requirements and' and provides an extension of tenure for large value funds for a tenure of up to five years, for accredited investors, subject to the approval of two-thirds of unit holders, subjecting any further extensions to the approval of the Board, under Regulation 13. Under clause (c) of sub-regulation (1) of Regulation 16, Category-I Alternative Investment Funds are restricted from borrowing or leveraging for investments, except for short-term operational needs up to 10% of investable funds, for 30 days on up to four occasions annually, and may encumber equity in infrastructure-focused investee companies to facilitate their borrowing, as per Board conditions. Clause (c) of Regulation 17 now similarly restricts Category II Alternative Investment Funds from borrowing or leveraging for investments, with the same limits for operational needs and equity encumbrance for infrastructure project borrowings, subject to Board conditions.

Valuation of Additional Tier 1 Bonds (AT-1 Bonds) by Mutual Funds

The Securities and Exchange Board of India *vide* Circular SEBI/HO/IMD/PoD1/CIR/P/2024/106, dated 5 August 2024, has addressed the valuation of Additional Tier 1 Bonds ('**AT-1 Bonds**') by Mutual Funds ('**MFs**'), in reference to clauses 9.3.1.1 and 9.4.2 of the Master Circular issued on MFs on 27 June 2024. This circular emphasizes SEBI's intent to ensure that valuation practices for AT-1 Bonds are consistent with market practices and regulatory standards. Following are the key takeaways:

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1. *Recommendation by NFRA* - The National Financial Reporting Authority ('**NFRA**') recommended that AT-1 Bonds, which are typically traded closer to Yield To Call ('**YTC**') prices, should be valued based on the YTC basis. This aligns with the principles of market-based measurement under Ind AS 113.
2. *Clarification by NFRA* - NFRA clarified that their recommendation on the YTC methodology pertains only to the interpretation of Ind AS 113 for the valuation of AT-1 Bonds. The deemed maturity date for other purposes remains outside NFRA's remit. To align with NFRA's recommendation, SEBI has decided that MFs must value AT-1 Bonds based on YTC.
3. For other purposes, the liquidity risk of perpetual bonds must be adequately captured, and the deemed maturity of all perpetual bonds will continue as per clause 9.4.2 of the Master Circular.

Master Circular for Real Estate Investment Trusts (REITs) amended

The Securities and Exchange Board of India *vide* Circular SEBI/HO/DDHS/DDHS-PoD-2/P/CIR/2024/108, dated 6 August 2024, has introduced the amendments to the Master Circular for Real Estate Investment Trusts, regarding board nomination rights for unitholders. The initial clause in the Master Circular dated 15 May 2024, restricted unitholders from nominating a director to the Manager's Board if they already had such rights as shareholders or lenders. Additionally, in response to market requests for clarifications on the same, SEBI added a proviso under Paragraph 18.2.2(b) of the Master Circular, that exempts this restriction if the right to appoint a nominee director is granted under clause (e) of sub-regulation (1) of Regulation 15 of the SEBI (Debenture Trustees) Regulations, 1993.

Master Circular for Infrastructure Investment Trusts (InvITs) amended

The Securities and Exchange Board of India *vide* Circular SEBI/HO/DDHS/DDHS-PoD-2/P/CIR/2024/109, dated 6 August 2024, has amended the Master Circular for Infrastructure Investment Trusts ('**InvITs**') specifically addressing the board nomination rights of unitholders. The amendment clarifies that if an entity has the right to appoint a nominee director as a shareholder or lender to the Investment Manager or the InvIT, it may also have the right to nominate a Unitholder Nominee Director. This change was made in response to industry requests for clarity and to promote ease of doing business. The

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amendment comes into immediate effect, and stock exchanges are required to disseminate the information on their websites.

SEBI issues modalities for migration of Venture Capital Funds

The Securities and Exchange Board of India *vide* Circular SEBI/HO/AFD/AFD-POD-1/P/CIR/2024/111, dated 19 August 2024, has outlined the modalities for the migration of Venture Capital Funds ('**VCFs**') registered under the erstwhile SEBI (Venture Capital Funds) Regulations, 1996, to the SEBI (Alternative Investment Funds) Regulations, 2012. It provides a clear framework for VCFs to transition to AIF Regulations, offering flexibility while ensuring that all regulatory requirements are met during the migration process, and states that VCFs can migrate to the newer AIF Regulations to manage unliquidated investments after their tenure ends, by applying to SEBI with their original registration certificate.

VCFs with active schemes have to migrate by 19 July 2025, with the scheme's tenure either continuing as disclosed or determined by investor approval. VCFs with expired schemes can also migrate, provided they have no pending investor complaints, and will be granted an additional one-year liquidation period. Upon migration, the existing investors and investments will be transferred to the new AIF structure. It has also been notified that those who do not migrate will face stricter regulatory requirements, if they continue operations beyond their allowed period.

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Ratio Decidendi

- Judicial interference under Article 226 of Constitution is limited when Arbitral Tribunal's Order related to conduct of arbitration proceedings is challenged – *Delhi High Court*
- Arbitral Tribunal or Courts are not empowered to grant compound interest or interest on interest unless expressly authorized by statute or contractual agreement – *Supreme Court*
- MSME loan accounts cannot be classified as NPAs without following the procedure laid down in the Framework for Revival and Rehabilitation of MSMEs – *Supreme Court*
- Section 4 of the Limitation Act does not allow a 30-day extension for Arbitration Appeals filed more than 3 months after the date of the Award – *Supreme Court*

Judicial interference under Article 226 of Constitution is limited when Arbitral Tribunal's Order related to conduct of arbitration proceedings is challenged

The Delhi High Court in a writ petition related to an interim order passed in an Arbitration, has held that a writ cannot be entertained against every interlocutory order dealing with the conduct of the arbitral proceedings. Such orders are within the domain and discretion of the Arbitral Tribunal ('**Tribunal**'), which includes orders considering the request of parties to summon witnesses, production of documents, etc. The Hon'ble Court further held that the scope of judicial interference under Article 226 of the Constitution is limited when an interim order of an Arbitral Tribunal is under challenge *via* a writ petition.

In the present case, M/s. Hindustan Alloys Pvt. Ltd. ('**Petitioner**') filed a statement of claim before a Sole Arbitrator under the Delhi International Arbitration Centre ('**DIAC**'). Initially, M/s. Maa Sheetla Ventures Ltd. ('**Respondent**') was set *ex-parte*, and issues were framed. However, the *ex-parte* order was later set aside and the Respondent was permitted to file its statement of defence. During the arbitration proceedings, the Petitioner filed an application under Sections 19 and 27 of the Arbitration and Conciliation Act, 1996 ('**Arbitration Act**') read with Rules 25.3 and 25.4 (c) of the DIAC Rules, 2023 to reopen the Petitioner's evidence, summon additional witnesses, direct the Respondent to produce documents. The said application was rejected by the Tribunal *vide* its Order dated 24 July 2024. Aggrieved by the same, the Petitioner filed a Writ Petition under Articles 226 and 227 of the Constitution challenging the order of the Tribunal.

The Hon'ble Court observed that, although writ petitions under Articles 226 and 227 of the Constitution can be filed against orders issued by quasi-judicial bodies, such as Arbitral Tribunals, the scope for judicial review in these matters is significantly limited. This limitation is based on the principle that the Court should intervene cautiously and only in rare or exceptional circumstances i.e., where the order passed is patently illegal and in violation on the fact of it.

The Hon'ble Court relied on the judgment of *Bhaven Construction* v. *Executive Engineer Sardar Sarovar Narmada Nigam Ltd.*, (2022) 1 SCC 75, wherein the Hon'ble Supreme Court had held that every petition filed under Article 226 of the Constitution must be entertained by the High Court, ignoring the fact that the aggrieved person has an effective alternative remedy. The Apex Court had observed that however, when a statutory forum is created by law for the redressal of grievances, a writ petition

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should not be entertained ignoring the statutory privilege granted to the forums. It was also stated that this power needs to be exercised in exceptional rarity, wherein one party is left remediless under the statute, or a clear 'bad faith' is shown by one of the parties.

Considering the same, the High Court held that the circumspect scope of interference under Article 226 becomes even narrower when it is an order of the Tribunal concerning the conduct of arbitration proceedings that is called into question. Remedy against such orders would lie against an interim award or final award that the Tribunal passed, and it is always open to the aggrieved litigants to challenge the said orders under Sections 34 and 37 of the Arbitration Act.

[*Hindustan Alloys Pvt. Ltd.* v. *Maa Sheetla Ventures Limited* – Judgement dated 31 July 2024 in W.P.(C) 10561/2024, Delhi High Court]

Arbitral Tribunal or Courts are not empowered to grant compound interest or interest on interest unless expressly authorized by statute or contractual agreement

The Supreme Court has held that Arbitral Tribunals or Courts are not empowered to grant interest on interest or compound interest except where it has been specifically provided under the statute or where there is a specific stipulation to that effect under the terms and conditions of the contract.

The instant case originated from a contract executed in the year 1984-85 between M/s. D. Khosla and Company ('**Petitioner**') and the Union of India ('**Respondent**') regarding which an award was passed by an Arbitrator under the Indian Arbitration Act, 1940. The Arbitrator awarded interest for two periods i.e., @ 12% per annum (simple interest) from the date of completion of the work up to the date of the award, and @ 15% per annum from the date of the award till the date of its payment, whichever is earlier.

The Petitioner received the principal compensation and the interest for both periods. However, the Petitioner sought additional interest, contending that the 15% interest should apply not only to the principal amount but also to the 12% interest awarded for the pre-award period. The Principal Senior Civil Judge and the Hon'ble High Court dismissed this claim, holding that the Arbitrator had used the word 'simple interest' and had not specifically awarded compound interest, therefore, the Petitioner is only entitled to simple interest. Aggrieved by the decision of the High Court, the Petitioner preferred a Special Leave Petition ('**SLP**').

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The Hon'ble Supreme Court observed that Section 3(3) of the Interest Act, 1978 does not permit the courts to award interest upon interest. Further, Section 29 of the Arbitration Act provides that the court in a decree cannot order payment of interest on interest but only on the principal sum adjudged. The Hon'ble Supreme Court placed reliance on *Oil and Natural Gas Commission* v. *M.C. Clelland Engineers S.A.*, (1999) 4 SCC 327, wherein it was held that the Arbitrators have the power to grant interest akin to Section 34 Code of Civil Procedure, 1908, and interest is not permissible upon interest awarded but only upon the claim made.

Considering the same, the Hon'ble Supreme Court held that the award and the decree nowhere specifically contemplate awarding 15% interest per annum on the amount awarded including the interest component. The Hon'ble Supreme Court further held that the courts are not empowered to grant compound interest or interest on interest unless there is a provision to that effect under the relevant statutes or the contract. Thereby, the Hon'ble Supreme Court dismissed the SLP, finding it inappropriate to exercise the discretionary jurisdiction under Article 136 of the Constitution of India.

[*D. Khosla & Company* v. *Union of India* – Judgement dated 7 August 2024, 2024 INSC 587, Supreme Court of India]

MSME loan accounts cannot be classified as NPAs without following the procedure laid down in the Framework for Revival and Rehabilitation of MSMEs

The Supreme Court has held that Banks are obligated to follow the mandatory procedure laid down in the Framework for Revival and Rehabilitation of MSMEs issued *vide* notification dated 29 May 2015 ('**Notification dated 29 May 2015**'), along with the RBI Directions before classifying a Micro, Small, and Medium Enterprises ('**MSME**') bank account as a Non-Performing Asset ('**NPA**').

In the present case, the Appellants are registered Micro/Small enterprises under the Micro, Small and Medium Enterprises Development Act, 2006 ('**MSMED Act**') and had preferred writ petitions before the Bombay High Court challenging the actions taken by the Respondent Banks/Non-Banking Financial Companies ('**NBFCs**') against the Appellants under the provisions of the SARFAESI Act, 2002, that the Respondent Banks could not have classified the loan amounts of the Appellant as NPA without following the procedure laid down in the Notification dated 29 May 2015. The Bombay High Court *vide* order dated 11 January 2024 dismissed the writ petitions

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stating that the Banks/ NBFCs are not required to follow the restructuring process as contemplated in the Notification issued by the Ministry of MSME, on its own unless any application is made by MSMEs. Aggrieved by the same, the Appellants preferred an appeal against the impugned order passed by the Bombay High Court.

The Supreme Court observed that the Reserve Bank of India, exercising its powers under Sections 21 and 35A of the Banking Regulation Act, 1949, issued the 'Reserve Bank of India [Lending to Micro, Small, and Medium Enterprises (MSME) Sector] Directions, 2016' wherein Direction 4 in Chapter IV, outlines the common guidelines for lending to the MSME sector. As per the said Directions, the Scheduled Commercial Banks are required to follow such guidelines pertaining to MSMEs. Considering the same, it is evident that the instructions for the Framework for Revival and Rehabilitation of MSMEs, as specified in the Directions, have statutory force and are binding on all Scheduled Commercial Banks licensed by the Reserve Bank of India to operate in India.

The Court further observed that under the 'Framework for Revival and Rehabilitation of MSMEs', the banks or creditors are required to identify the incipient stress in the account of the MSMEs, before their accounts are turned into NPAs, by creating Special Mention Account ('**SMA**').

The Apex Court held that the impugned order by the High Court was highly erroneous as the Banks are obliged to adopt the restructuring process on their own and the Framework contained in the Notification dated 29 May 2015 is mandatory in nature.

[*Pro Knits* v. *The Board of Directors of Canara Bank*, Judgement dated 1 August 2024, 2024 INSC 565, Supreme Court of India]

Section 4 of the Limitation Act does not allow a 30-day extension for Arbitration Appeals filed more than 3 months after the date of the Award

The Supreme Court has held that the period of 30 days mentioned in the proviso of Section 34(3) of the Arbitration and Conciliation Act, 1996 (**'Arbitration Act')** is not the 'prescribed period' and hence, the benefit of Section 4 of the Limitation Act, 1963 ('**Limitation Act**') cannot be invoked using the 30-day extension period provided under Section 34 for arbitration appeals filed beyond 3-months from the receipt of the award.

The State of West Bengal & Ors. ('**Appellants**') appointed M/s. Rajpath Contractors ('**Respondent**') for the construction of a bridge. Disputes arose between the parties leading the

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Respondent to invoke the arbitration clause in the contract, after which a sole arbitrator was appointed. On 30 June 2022, the Arbitral Tribunal issued an award directing the Appellants to pay a sum of INR 2,11,67,054/- to the Respondent with interest thereon.

The counterclaim made by the Appellants was dismissed and the Appellants received a copy of the award on the same day.

The Appellants intended to challenge the award under Section 34 of the Arbitration Act. However, the Calcutta High Court ('**High Court**') was closed for vacation on account of Durga Pooja from 1 October 2022 to 30 October 2022. The Appellants filed their petition on 31 October 2022. The High Court dismissed the petition on 4 May 2023, on grounds of limitation, stating that the petition was time-barred. The High Court held that the limitation period expired on 30 September 2022, and thus, the petition filed on 31 October 2022, was beyond the permissible period. Being aggrieved by the view taken by the High Court, the Appellants have preferred this appeal.

The Court observed that the crucial words in Section 4 of the Limitation Act are prescribed period which is defined under Section 2(j) of the Limitation Act, so when Section 2(j) is read in the context of Section 34(3) of the Arbitration Act it becomes clear that the prescribed period for making an application for setting aside an arbitral award is three months. The period of 30 days mentioned in the proviso of Section 34(3) of the Arbitration Act is not the 'period of limitation' and, therefore, not the 'prescribed period' for the purposes of making an application for setting aside the arbitral award.

The Court observed that in the present case, the three months provided by way of limitation expired a day before the commencement of the vacation, which commenced on 1 October 2022. Thus, the prescribed period within the meaning of Section 4 of the Limitation Act ended on 30 September 2022. Therefore, the Appellants were not entitled to take benefit of Section 4 of the Limitation Act. As per the proviso of Section 34(3), the period of limitation could have been extended by a maximum period of 30 days. The maximum period of 30 days expired on 30 October 2022 and the petition was filed on 31 October 2022. Considering the same, the Court held that the High Court was right in holding that the petition filed by the Appellants under Section 34 of the Arbitration Act was not filed within the period specified under sub-section (3) of Section 34, and hence, the petition was accordingly dismissed.

[*State of West Bengal & Ors.* v. *Rajpath Contractors and Engineers Ltd.* – Judgement dated 8 July 2024, [2024] 7 S.C.R. 1: 2024 INSC 477, Supreme Court of India]

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News Nuggets

- DPIIT seeks distinction between the ‘game of skill’ and the ‘game of chance’
- Labour Codes – Centre seeking a legal pathway for implementation
- Platform to connect exporters, government agencies, and MSMEs being explored
- MCA likely to strike-off around 400 Chinese companies over the next few months
- PSUs granted additional 2-year exemption from minimum public shareholding norms
- Liquor surrogate advertisements rules set to be revamped

DPIIT seeks distinction between the 'game of skill' and the 'game of chance'

As per an official of the Department for Promotion of Industry and Internal Trade ('**DPIIT**'), a note has been circulated by the DPIIT amongst various Ministries seeking their views on the difference between an online 'Game of Skill' and a 'Game of Chance'. As per reports, this is required for the purpose of further evaluating permitting Foreign Direct Investment ('**FDI**') and attract foreign investments in the sector of games of skill which boasts huge potential.

[*Source:* Economic Times, published on 20 August 2024]

Labour Codes – Centre seeking a legal pathway for implementation

As per reports, the Centre has sought the Law Ministry's views on whether the Union Government may proceed with the implementation of the proposed labour codes even without the approval of the States. Notably, this comes pursuant to West Bengal's complete denial to implement the proposed labour codes and States like Tamil Nadu and Delhi agreeing to partial implementation of the codes.

[*Source:* Money Control, published on 13 August 2024]

Platform to connect exporters, government agencies, and MSMEs being explored

The Ministry for Commerce and Industry is said to be in the process of developing a trade connect e-platform to connect exporters, Micro, Small and Medium Enterprises ('**MSMEs**') and entrepreneurs with various stakeholders, including Indian missions abroad, export promotion councils, and other partner government agencies. It is expected that the e-platform will provide information on trade events taking place in different parts of the world, benefits available due to India's free trade agreements ('**FTAs**'), and other information relating to international trade.

[*Source:* SMB Story, published 7 August 2024]

MCA likely to strike-off around 400 Chinese companies over the next few months

As per reports, over 700 Chinese companies have been under the scanner of the Ministry of Corporate Affairs ('**MCA**') in the recent past and the MCA may strike off up to 400 of such companies owing to incorporation and financial frauds. It is expected that as per the applicable laws, the companies will be sent a notice, giving them time to respond and if they fail to respond, another follow-up notice will be sent a month after the

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initial one failing which will result in the removal of the companies.

[*Source:* Money Control, published on 2 August 2024]

PSUs granted additional 2-year exemption from minimum public shareholding norms

The Government has exempted central public sector enterprises and public financial institutions ('**PSUs**') from the requirement of meeting minimum public shareholding for an additional period of two years. However, the Securities and Exchange Board of India ('**SEBI**') is yet to come out with a detailed notification of the extension granted by the Government. Notably, the SEBI regulations mandate a listed company to maintain a minimum public shareholding of 25 per cent.

[*Source:* Business Standard, published on 1 August 2024]

Liquor surrogate advertisements rules set to be revamped

As per reports, the Union Ministry of Consumer Affairs is drafting new rules that aim to address surrogate advertising adopted by liquor companies to indirectly promote liquor products. Currently, the advertisements of liquor companies show glass tumblers, playing cards, and music CDs to implicitly promote their alcohol products. In this regard, the new rules may require such companies to halt these 'surrogate' advertisements unless they can consistently demonstrate that these items have their own independent market.

[*Source:* BW Marketing World, published on 31 July 2024]

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