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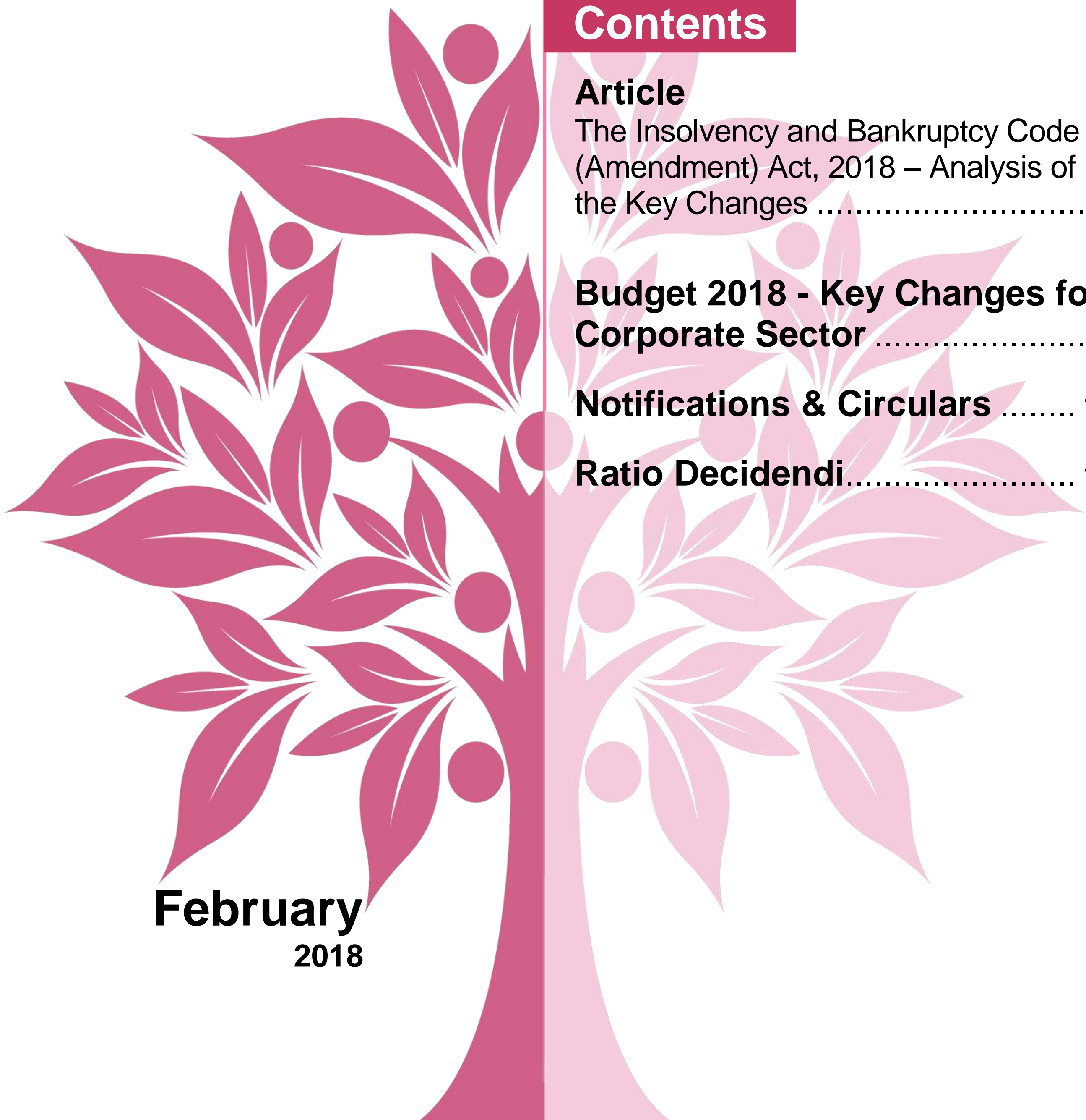

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Article

The Insolvency and Bankruptcy Code (Amendment) Act, 2018 – Analysis of the Key Changes

By **Aishwarya Dubey**

Background

The Insolvency & Bankruptcy Code, 2016 (the "Code") consolidated the archaic insolvency laws, provided a consolidated legislation and revolutionised the insolvency regime in India. Undoubtedly, the Code has had a significant impact on the way corporate India functions. It has been almost two years since the Code came into effect and in the year 2017 some significant amendments have been made to the Code based on inputs received from various market participants.

The President of India while exercising his power under Article 123 of the Constitution of India on November 23, 2017 promulgated the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2017 ("Ordinance") which amended the existing Code. The purpose of this Ordinance was to strengthen the Corporate Insolvency Resolution Process ("CIRP").

The Insolvency and Bankruptcy Code (Amendment) Bill, 2017 was introduced to replace the Ordinance. The bill was passed by both houses of the Parliament and received President's assent on January 18, 2018 to become the Insolvency and Bankruptcy (Amendment) Act, 2018 (the "Amendment Act").

The Amendment Act has a retrospective effect as it is deemed to be in force from November 23, 2017. This also means that it nullifies the Ordinance which came into force on same day and any action which was governed by the Ordinance will be governed by the Code as amended by the Amendment Act.

Analysis of the key changes made by the Amendment Act

Application of the Code

The Amendment Act by amending Section 2 of the Code, extends the application of the Code to personal guarantors of the corporate debtor and proprietorship firms who were earlier immune from any liability under the Code. This has brought clarity on the initiation of CIRP against the personal guarantors of the corporate debtor as prior to the Amendment Act, the Allahabad High Court in case of *Sanjeev Shriya* v. *State Bank of India*[1], observed that personal guarantors of the corporate debtors were not expressly covered under the CIRP contemplated in the Code. The Amendment Act now brings the much-needed clarity in relation to the applicability of the Code to personal guarantors, who now fall within its ambit.

Further, proprietorship model of business is most common amongst small and medium enterprises in India and there was no special legislation governing the insolvency of a proprietorship concern. Hence, inclusion of proprietorship firms under the insolvency regime is a welcome move and will reduce the scope of default by such firms.

Invitation to resolution applicants

The term resolution applicant was previously defined in the Code as "*any person who submits a resolution plan to the resolution professional*".

[1] 2017 (9) ADJ 723

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This definition was a cause of debate and confusion as two different schools of thought existed regarding the interpretation of the definition.

On one hand, it was argued that the definition of resolution applicant should be read in consonance with Section 25(2)(h) of the Code which requires the resolution professional to invite prospective lenders, investors, and any other person to put forward a resolution plan. Therefore, only a person who is invited by the resolution professional could submit his resolution plan and was considered as a resolution applicant. On the other hand, the line of argument was that the definition of resolution applicant in the Code does not make any reference to Section 25 of the Code and hence, the resolution plan can be submitted by any person irrespective of whether he has been invited to do so by the resolution professional. The resolution professional upon receiving any resolution plan from any such uninvited resolution applicant was also bound to review and examine the resolution plan.

This debate has been put to rest by the Amendment Act by amending the definition of resolution applicant. Now, a resolution applicant means "*a person, who individually or jointly with any other person, submits a resolution plan to the resolution professional pursuant to the invitation made under clause (h) of sub-section (2) of section 25*". Therefore, the resolution professional is now obligated to review and examine the resolution plan submitted by only such persons who have been expressly invited by the resolution professional to submit a resolution plan.

Further, the Amendment Act also provides that the resolution plan can now be submitted by any person either singly or jointly with any other person. This will facilitate the CIRP of large distressed assets.

Qualifying criteria for resolution applicants

The Amendment Act amends the liberty provided to the resolution professional laid down in Section 25 of the Code. Previously, the resolution professional had the liberty to invite any prospective lender, investor, and any other person to put forward a resolution plan. However, the Amendment Act provides that the resolution professional must now determine eligibility criteria, with the approval of the committee of creditors, for persons who can be invited by the resolution professional for presenting the resolution plan. While determining the eligibility criteria, the resolution professional is now obligated to give due regard to the complexity and scale of operations of the business of the corporate debtor.

This amendment would ensure that only persons with sufficient and relevant financial, legal and technical competency submit the resolution plan.

Disqualification from submitting resolution plan

Prior to the Amendment Act, it was becoming increasingly common amongst the unscrupulous promoters of corporate debtors to themselves submit a resolution plan in a CIRP for their own distressed company and thereby be the resolution applicant.

In order to curb such practices, the Amendment Act has now added a new provision in form of Section 29A in the Code. This amendment is made in line with the Ordinance. However, unlike the ordinance, the Amendment Act uses the word 'persons acting jointly or in concert' which implies that apart from the ineligible person any other person acting together with such person for a common objective is also ineligible to be a resolution applicant.

Section 29A of the Code now makes certain persons ineligible to submit a resolution plan, if such person, or any person acting jointly with

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such person, is: (i) an undischarged insolvent; (ii) a wilful defaulter; (iii) a person who has an account or an account of a corporate debtor under the management or control of such person, classified as non-performing asset and a period of one year has lapsed since such classification; (iv) a person convicted of any offence punishable with imprisonment for two years or more; (v) a person disqualified to act as a director under the Companies Act, 2013; (vi) a person prohibited by the Securities and Exchange Board of India from trading in securities or accessing the capital markets; (vii) a person who has been a promoter or in the management or control of a corporate debtor in which a preferential or undervalued or extortionate credit or fraudulent transaction has taken place in respect of which an order has been made by the National Company Law Tribunal ("NCLT"); (viii) a person who has executed an enforceable guarantee in favor of a creditor, in respect of a corporate debtor undergoing CIRP; ix) a person who has been subject to any disability, corresponding to clauses (i) to (viii) above, under any law in a jurisdiction outside India.

The Amendment Act, prohibits a person who has a 'connected person' suffering from any of the disqualifying factors mentioned in (i) to (ix) above also from presenting a resolution plan. The term 'connected person' means any person (i) who is the promoter or in the management or control of the resolution applicant; or (ii) who shall be the promoter or in management or control of the business of the corporate debtor undergoing the CIRP; or (iii) the holding company, subsidiary company, associate company or related party of a person referred to in clauses (i) and (ii) above but not including a scheduled bank, an asset reconstruction company and an alternative investment fund.

Therefore, contrary to the popular perception, not all 'connected persons' are disqualified from submitting a resolution plan but only those specific 'connected persons' suffering from the disqualifying factors mentioned in (i) to (ix) above are disqualified from submitting a resolution plan.

As mentioned above, a person who has executed an enforceable guarantee in favor of a creditor, in respect of a corporate debtor undergoing CIRP is also not eligible to submit a resolution plan. In this regard, there was a lot of confusion whether any guarantor will be disqualified from submitting a resolution plan or only defaulting guarantors will be disqualified. On December 18, 2017, the NCLT, Kolkata Bench in *RBL Bank Limited* v. *MBL Infrastructure Limited*[2], dealt with this issue and observed that only such class of guarantors who on the account of their antecedent, may adversely impact the credibility of the CIRP under the Code will be disqualified from submitting a resolution plan. The NCLT further explained that the antecedent of the guarantor can only be questioned if the guarantor has defaulted and not honored his lawful contractual obligation or has conspired with the promoter in deliberately causing insolvency of the corporate. Hence, the rationale behind disqualifying guarantors from submitting resolution plan is not to disqualify promoters as a class of resolution applicant but to exclude such class of persons who may adversely affect the reliability of the CIRP under the Code. Therefore, a guarantor cannot be disqualified only on the ground of existence of a binding contract of guarantee but shall stand disqualified only upon default. However, an appeal has been preferred against this order and the matter still lies undecided before the National Company Law Appellate Tribunal.

Therefore, the abovementioned disqualification factors narrow down the scope of potential suitors who will be able to submit a bid for stressed assets and the number may reduce

[2] C.A. (I.B.) No 543/KB/2017

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significantly. But it is a welcome change considering it disqualifies persons having poor antecedents from taking part in the CIRP process and thereby improving its credibility. It would be mandatory for the resolution applicants to disclose all details about themselves and the persons acting in concert with them for submission of the resolution plans. This would also lead to more transparency.

Submission of resolution plan

The Amendment Act also amends Section 30(4) of the Code and provides that committee of creditors must approve the resolution plan by a vote of not less than seventy-five per cent of voting shares of financial creditors. The approval of the resolution plan must be given only after considering the viability and feasibility of such a resolution plan. The committee of creditors cannot approve any resolution plan submitted before November 23, 2017 by persons disqualified under factors provided under Section 29A of the Act and if no other resolution plan is available with the creditors committee then it should invite fresh resolution plans. This may adversely affect the CIRP which are in penultimate stage of the completion and give rise to unnecessary litigation. However, it is important that even at the cost of quick closure of CIRP, the transparency and credibility should be improved otherwise the corporate debtor undergoing CIRP will move from one insolvency phase to another and only persons with doubtful antecedents will benefit. Further, if a resolution plan is submitted by a person whose account has been classified as non-performing asset for a period of more than one year, then a cure period of 30 days from the date of submission of the resolution plan is available to such a person to make payment of the overdue amount along with the interest and charges thereon.

Prohibition on sale of distressed assets to disqualified persons

The amendment to Section 35 of the Code ensures that properties or actionable claims of a corporate debtor undergoing CIRP are sold to a person who is eligible to be a resolution applicant and bars the sale of any immovable or movable property or actionable claim of the corporate debtor undergoing CIRP by the liquidator to a person not eligible to be resolution applicant. This amendment safeguards that the liquidator also ensures that the buyer of a distressed asset is eligible and not disqualified under any of the criteria laid down in Section 29A.

Punishment where no specific punishment or penalty is provided

The Amendment Act introduces a new provision in form of Section 235A. This section prescribes a fine of not less than one lakh rupees which can be extended up to two crore rupees if any person contravenes any provision of the Code or rules and regulations made under it if no penalty is prescribed for such contravention specifically.

Conclusion

The objective of the Amendment Act primarily is to prevent unscrupulous persons from misusing or vitiating the provisions of the Code. The Amendment Act has been designed to fine tune and streamline the CIRP and deal with many of the contentious issues raised under it. It ensures transparency in the CIRP by imposing strict eligibility criteria for being a resolution applicant and presenting a resolution plan and by introducing multiple layers of safeguard. It also attempts to remove the backdoor entry of unscrupulous promoters. Such wide scope of disqualifications will restrict the number of participants in the CIRP but improve its credibility. However, it will be intriguing to see how promoters, who have defaulted because of

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factors beyond their control such as genuine poor business performance and now are ineligible to submit resolution plans, choose to react to the Amendment Act. The consequences of rendering certain class of people ineligible to participate in CIRP may have unintended results.

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Budget 2018: Key Changes for Corporate Sector in India

The Finance Minister of India, made the budget speech for the Financial Year 2018-2019 ("Budget Speech") and presented the Finance Bill, 2018 ("Finance Bill") on February 1, 2018. Amongst several measures that were announced as part of the Budget Speech and Finance Bill, from a policy and developmental perspective, there were certain announcements made which may have impact in the corporate sector in general and particularly the mergers and acquisition activities in India. In addition to the several proposed amendments to the tax laws, it was announced that the provisions of Reserve Bank of India Act, 1934 ("RBI Act"), Securities and Exchange Board of India, Act 1992 ("SEBI Act"), Securities Contracts (Regulation) Act 1956 ("SCRA"), and Depositories Act 1996 ("Depositories Act"), will be amended. These proposed amendments have been provided in the Finance Bill.

Given below are various amendments proposed in the Budget Speech and the Finance Bill:

1. Section 17(1A) is being inserted in the RBI Act to provide for an additional business activity of RBI with respect to accepting of money as deposits, repayable with interest, from banks or any other person under the Standing Deposit Facility Scheme, as approved by the Central Board of Directors of the RBI, from time to time, for the purposes of liquidity management.

   The concept of "standing deposit facility" was first introduced by the Urjit Patel Committee Report in 2014, which stated that standing deposit facilities are transparent facilities, available to banks and other counter parties without discretionary hurdles, and are generally considered as the safety valve of a liquidity management system. It is a remunerated facility that will not require the provision of collateral for liquidity absorption.

   This provision has been proposed to be inserted in order to facilitate efficient liquidity management by RBI.

2. The penalties for failure to (i) furnish information, return, (ii) comply with provision of listing conditions or delisting conditions or grounds and (iii) furnish periodical returns, under the SCRA are proposed to be enhanced.

   The amendment has been proposed to provide for penalties for certain contraventions under the SCRA and to further regulate wealth management funds such as real estate investment trust, infrastructure investment trust and alternative investment fund.

3. All settlement amounts, excluding the disgorgement amount and legal costs, realized under the SCRA, SEBI Act and Depositories Act are proposed to be

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credited to the 'Consolidated Fund of India'.

All revenues received by the Government by way of taxes like Income Tax, Central Excise, Customs and other receipts flowing to the Government in connection with the conduct of Government business i.e. non-tax revenues are credited into the Consolidated Fund of India constituted under Article 266 (1) of the Constitution of India.

This amendment has been proposed to enhance the revenue of the Government.

4. Provisions with respect to continuation of SEBI recovery proceedings have been introduced under the SCRA, SEBI Act and Depositories Act against a legal representative for recovery of sums due from defaulter even when the defaulter person dies.

5. Sections 15EA is being inserted in the SEBI Act to provide that where any person fails to comply with the regulations made by the SEBI in respect of alternative investment funds, infrastructure investment trusts and real estate investment trusts or fails to comply with the directions issued by the SEBI, such person shall be liable to penalty which shall not be less than INR. 1 lakh but which may extend to INR. 1 lakh for each day during which such failure continues subject to a maximum of INR. 1 crore or three times the amount of gains made out of such failure, whichever is higher.

   The amendment has been proposed to provide for penalties for certain contraventions with respect to wealth management funds such as real estate investment trust, infrastructure investment trust and alternative investment fund.

6. Section 15EB under the SEBI Act is being inserted which provides that an investment adviser or a research analyst who fails to comply with SEBI regulations would be liable for fine of not less than INR. 1 lakh. The quantum can extend to INR. 1 lakh for each day during which such failure continues subject to a maximum of INR. 1 crore.

7. New provision Section 23GA is being inserted to SCRA providing that where a stock exchange or a clearing corporation fails to conduct its business with its members or any issuer or its agent or any person associated with the securities markets in a manner not in accordance with the rules or regulations made by the SEBI and the directions issued by it under SCRA, the stock exchange or the clearing corporations, as the case may be, shall be liable to penalty which shall not be less than INR. 5 crores but which may extend to INR. 25 crores or 3 times the amount of gains made out of such failure, whichever is higher.

   This amendment has been proposed in order to deal with the failure of a stock exchange or a clearing corporation to conduct its business in a manner, which is not in accordance with the rules and regulations made by SEBI.

8. Section 19FA is being inserted in the Depositories Act which provides that a depository which fails to conduct its business with its participants or any issuer or its agent or any person associated with the securities markets in a fair manner as per SEBI regulations would be liable for fine of not less than INR. 5 crores and extend up to INR. 25 crores or 3 times the amount of gains made out of such failure, whichever is higher.

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9. It has been proposed that the provision of Section 79 of the IT Act regarding restriction on shareholding for the purpose of carry forward loss shall not apply in case of change of shareholding pursuant to an approved resolution plan under the Insolvency and Bankruptcy Code, 2016 ("IBC") where an opportunity of being heard has been given to the principal commissioner or commissioner, appointed under the IT Act.

   Under the Income Tax regime, a company is only permitted to deduct from its book profits, the loss brought forward or unabsorbed depreciation, whichever is lower, as per books of account. However, under the Finance Bill, it is proposed that in respect of companies where an application under IBC has been admitted by the adjudicating authority, it is proposed to provide that for the purpose of computation of Minimum Alternative Tax ("MAT") the aggregate amount of unabsorbed depreciation and brought forward loss shall be allowed to be reduced from the book profit.

10. In order to encourage start-ups and to provide for an effective start-up regulation in India, the definition of "eligible business" for a start-up is proposed to be aligned with the modified definition notified by DIPP. It is further proposed to extend the incorporation date for a start-up for availing benefit under Section 80-IAC of the IT Act to March 31, 2021 from March 31, 2019 and rationalise the condition of turnover for availing the benefit.

    Section 80-IAC *inter alia*, provides that deduction under the said section shall be available to an eligible start-up, if it is incorporated on or after the April 01, 2016 but before the April 01, 2019; the total turnover of its business does not exceed twenty-five crore rupees in any of the previous years beginning on or after the April 01, 2016 and ending on the March 31, 2021; and it is engaged in the eligible business.

    The aforesaid amendment to Section 80-IAC will take effect from April 01, 2018 and will, accordingly, apply in relation to the assessment year 2018-2019 and subsequent years.

11. A new explanation 2A to Section 2(22) of the Income Tax Act, 1961 ("IT Act") has been inserted which widens the scope of the term "accumulated profits". Under the new provision, accumulated profits, whether capitalised or not, or losses as the case may be, shall be increased by the accumulated profits of the amalgamating company, whether capitalised or not, on the date of amalgamation.

    This amendment has been proposed to curb companies from distributing proceeds to their shareholders in the form of dividends. Under the current regime, the companies with large accumulated profits adopted the amalgamation route to reduce capital and circumvent the provisions of sub-clause (d) of Section 2(22) of the IT Act, which states that dividend includes any distribution to its shareholders by a company on the reduction of its capital, to the extent to which the company possesses accumulated profits which arose after the end of the previous year ending next before the 1st day of April, 1933, whether such accumulated profits have been capitalised or not.

12. Section 56(2)(xi) has been inserted under the IT Act to provide that any compensation or other payment, due to or received by any person, by whatever

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name called, in connection with the termination of his employment or the modification of the terms and conditions relating thereto, shall be chargeable to income tax under the head "Income from other sources".

The amendment by making all compensations (whether capital or revenue in nature) received on termination of contract subject to tax has proposed to remove the ambiguity on whether any compensation received on the termination of a contract is taxable under the IT Act, considering that it was arguable to treat such compensation as capital receipt.

13. It has been proposed that all listed shares held for more than 1 (one) year will be subjected to long term capital gains tax of 10 (ten) percent if the capital gains on transfer of such listed shares exceeds INR.1,00,000.

    Currently, such transactions are exempted from long term capital gains. However, a relaxation has been provided by the Government that it exempted any long-term capital gains made until January 31, 2018 from the aforesaid levy of income tax.

    In light of the proposed amendment, the compliance and operational cost for investing in India will increase for foreign institutional investors (FIIs) as there will be dual tax for listed equities i.e. capital gains and securities transactional tax (STT).

Other amendments proposed under the Budget Speech:

1. The Finance Minister noted that hybrid instruments are suitable for attracting foreign investments in several niche areas, especially for the startups and venture capital firms and accordingly, has proposed that the Government will evolve a separate policy for the hybrid instruments. Currently, the eligible capital instruments under the FDI Policy are equity shares, fully, compulsorily and mandatorily convertible debentures and fully, compulsorily and mandatorily convertible preference shares. With the notification of this amendment, the Indian companies will also be able to raise foreign investment by issuing hybrid instruments by complying with the procedures proposed to be laid down by the Government.
2. The Government has proposed to bring out a coherent and integrated Outward Direct Investment (ODI) policy in India. Currently overseas direct investment from India is governed under the Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004 read with RBI Master Direction – Direct Investment by Residents in Joint Venture (JV) / Wholly Owned Subsidiary (WOS) Abroad.
3. The Finance Minister stated that the Government does not consider crypto-currencies legal tender or coin and will take all measures to eliminate use of these crypto assets in financing illegitimate activities or as part of the payment system.

   Earlier, the Ministry of Finance had issued a press release dated December 29, 2017, titled "*Government Cautions People Against Risks in Investing in Virtual 'Currencies', Says VCs are like Ponzi Schemes*", which stated that:

   - the virtual currencies ("VCs") don't have any intrinsic value and are not backed by any kind of assets. The price of bitcoin and other VCs therefore, is entirely a matter of mere speculation resulting in spurt and volatility in their prices; and

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- there is a real and heightened risk of investment bubble of the type seen in '*Ponzi schemes*' which can result in sudden and prolonged crash, exposing investors, especially retail consumers losing their hard-earned money. Consumers need to be alert and extremely cautious as to avoid getting trapped in such Ponzi schemes.

Further, the Finance Minister, in the 'Question Hour' session of the Rajya Sabha, answered to a query relating to regulation of cryptocurrencies that "***The Government does not consider cryptocurrencies to be a legal tender***".

4. It has been proposed that the capital market regulator SEBI will consider mandating corporates, beginning with large corporates, to meet about one-fourth of their financing needs from the bond market. The proposed amendment is aimed at deepening the corporate bond market. Making it mandatory to raise one-fourth of the total borrowing through bonds will increase the demand and supply for bond market in India.

5. The Government has proposed that no adjustment shall be made in respect of transactions in immovable property, where the circle rate value does not exceed 5% of the consideration. This amendment has been proposed to minimize hardship in real estate transactions.

6. Micro Units Development & Refinance Agency Ltd. ("MUDRA") provides loans at low rates to micro-finance institutions and non-banking financial companies ("NBFC") which then provide credit to micro, small and medium enterprises ("MSMEs"). It has been proposed that refinancing policy and eligibility criteria set by MUDRA will be reviewed for better refinancing of NBFCs.

   The Government has taken cognizance of more funding requirements for MSMEs and accordingly, this amendment has been proposed to encourage growth of MSMEs by providing easy norms for refinancing of NBFCs which will further provide loans to MSMEs.

7. Alternative investment funds are privately pooled investment vehicles that collect funds from both Indian and foreign investors, and are one of the most developing fund based wealth management activities in India. In recent times, there has been tremendous increase in investment made by the venture capital funds and angel investors in alternate investment funds, especially after liberalization under the FDI Policy.

   Accordingly, the Finance Minister noted that venture capital funds and the angel investors need an innovative and special developmental and regulatory regime for their growth and accordingly, it has been proposed that the Government will take additional measures to strengthen the environment for their growth and successful operation of alternative investment funds in India.

8. The Government has proposed that it will take reform measures with respect to stamp duty regime on financial securities transactions in consultation with the States and make necessary amendments the Indian Stamp Act, as adopted by different States.

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Notifications and Circulars

SEBI - Schemes of Arrangement by Listed Entities and relaxation under sub-rule 19(7) of Securities Contracts (Regulation) Rules, 1957: SEBI by its Circular No. CFD/DIL3/CIR/2018/2, dated January 3, 2018 has issued certain amendments to its existing Circular dated March 10, 2017 that lays down the framework for Schemes of Arrangement of listed entities ('Circular').

Henceforth, the Circular shall not apply to schemes which solely provides for merger of a wholly owned subsidiary or its division with the parent company. However, such draft schemes are required to be filed with the Stock Exchanges for disclosures and the Stock Exchanges are required to disseminate the scheme documents on their websites. The valuation report and fairness opinion must be provided by an Independent Chartered Accountant and an Independent SEBI Registered Merchant Banker, respectively. The percentage of shareholding of pre-scheme public shareholders of the listed entity and the Qualified Institutional Buyers (QIBs) of the unlisted entity shall not be less than 25% in the post scheme shareholding pattern of the "merged" company.

In case of a scheme involving merger of a listed company or its division into an unlisted entity, shares held by promoters up to 20% of the post-merger paid-up capital of the unlisted issuer shall be locked-in for a period of 3 years from the date of listing of the shares of the unlisted issuer. The remaining shares shall be locked-in for a period of 1 year from the date of listing of the shares of the unlisted issuer and no additional lock-in shall be applicable if the post scheme shareholding pattern of the unlisted entity is exactly like the shareholding pattern of the listed entity.

To ease fund-raising, SEBI has permitted shares locked-in to be pledged with any scheduled commercial bank or public financial institution as collateral security for loans, provided pledge of shares is a condition for sanction of such loan. Further, shares locked-in may also be transferred 'inter-se' among promoters in accordance with the ICDR Regulations.

Previously, a listed entity and/ or unlisted entity (transferee entity) was to ensure that steps for listing of specified securities were completed within 30 days from receipt of the order of High Court/ NCLT, and that trading in securities commenced within 45 days of such order. SEBI has extended these time limits - henceforth, steps for listing of specified securities are to be completed and trading in securities is to be commenced within 60 days of receipt of the order of the High Court/ NCLT, simultaneously on all the Stock Exchanges where the equity shares of the listed entity (or transferor entity) are/were listed.

RBI Circular for Refinancing of External Commercial Borrowings: Under the External Commercial Borrowings (ECB) framework, Indian corporates are permitted to refinance their existing ECBs at a lower all-in-cost. However, overseas branches/subsidiaries of Indian banks were not permitted to extend such refinance. The Reserve Bank of India ("RBI") *vide* its Circular No. 15CFD/DIL3/CIR/2018/2, dated January 4, 2018 has now permitted overseas branches and subsidiaries of Indian Banks to refinance existing ECB of highly rated (AAA) corporates along with Navratna and Maharatna PSUs, provided the

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outstanding maturity of original borrowing is not reduced and all-in cost of fresh ECB is lower than the existing ECB. Partial re-financing of existing ECBs is also subject to the same conditions.

IBBI (Fast Track Insolvency Resolution Process for Corporate Persons) (Fourth Amendment) Regulations, 2017: The Insolvency and Bankruptcy Board of India ("IBBI"), *vide* its Notification No. IBBI/2017-18/GN/REG23, dated December 31, 2017 has introduced certain amendments to the IBBI (Fast Track Insolvency Resolution Process for Corporate Persons) Regulations, 2017, *viz.* adding the definition of "dissenting financial creditor", which has been defined as a financial creditor who has voted against a resolution plan or has abstained from voting for the resolution plan, approved by the committee. Further, after the receipt of the resolution plan, the resolution professional is required to provide the liquidation value to every member of the committee in electronic form, on receiving an undertaking of confidentiality from them.

Negotiable Instruments (Amendment) Bill, 2017 introduced: The Negotiable Instruments (Amendment) Bill, 2017 ("NI Bill") was introduced in the Lok Sabha on January 2, 2018 to further amend the Negotiable Instruments Act, 1881 ("NI Act"). The NI Bill seeks to provide relief to payees of dishonoured cheques and to discourage frivolous and unnecessary litigation. The new provisions provide for the drawer of the cheque to pay interim compensation to the complainant. A new provision allows concerned courts to order the drawer of a dishonoured cheque to pay interim compensation of a sum not exceeding 20% of the amount of such cheque to the complainant, in a summary trial or a summons case where he or she pleads not guilty to the accusations upon framing of charges. If the drawer is acquitted, the court may direct the payee to repay the amount paid as interim compensation with interest within 60 days of the order or within the permissible extended period. A new provision provides that if a drawer convicted in a cheque bouncing case files an appeal, the appellate court may direct him to deposit a minimum of 20% of the fine or compensation awarded by the trial court during conviction in addition to any interim compensation paid by the drawer during the earlier trial proceedings.

The proposed amendments will strengthen the credibility of cheques and help trade and commerce by allowing lending institutions, including banks, to continue to extend financing to the productive sectors of the economy, according to the Statement of Objects and Reasons of the Bill. The Bill is in line with the Central Government's push to make India a less-cash economy.

Review of FDI Policy on various sectors (Press Release No. 1) (2018 Series): On January 10, 2018, the Union Cabinet approved changes in the Foreign Direct Investment Policy ("FDI Policy") allowing further liberalisation with a view to promote and provide ease of doing business in the country.[3] On January 23, 2018, the Department of Industrial Policy & Promotion notified the amendments by way of Press Note No. 1 (2018 Series).[4] These amendments will come into effect from the date of the FEMA notification in this regard. Certain key changes proposed are as follows:

Single Brand Retail Trading: The requirement of government approval route for FDI in this sector beyond 49% has been done away with. Now, the FDI Policy permits 100% FDI under automatic route for Single Brand Retail Trading.

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[3] Press Release posted on: 10 JAN 2018 1:03PM by PIB Delhi at http://pib.nic.in/PressReleseDetail.aspx?PRID=1516115; last accessed at 2:30PM on 23 JAN 2018

[4] Press Release No. 1 (2018 Series) posted on 23 JAN 2018 by DIPP at http://dipp.nic.in/sites/default/files/pn1_2018_0.pdf ; last accessed at 10.00PM on 24 JAN 2018

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A single brand retail trading entity can now set off its incremental sourcing of goods from India for global operations during the initial 5 years (beginning 1st April of the year of opening of its first store), against the mandatory sourcing requirement of 30% of purchases from India. After completion of this 5 year period, the Single Brand Retail Trading entity will be required to meet the 30% sourcing norms directly towards its India's operation, on an annual basis. Not only will 100% FDI being permitted through the automatic route in this sector remove barriers for foreign retail traders looking to make an entry into India thus giving access to various new foreign brands to domestic consumers, but also the relaxations in sourcing norms will allow such traders/manufacturers to test the waters in Indian markets first and thus, be in a better position to source locally once they have assessed and aligned their business requirements and arrangements in India.

In ***Civil Aviation***, although foreign investment in the capital of Indian-operated scheduled and non-scheduled airlines was permitted under the approval route up to 49%, 'Air India'(flagship national carrier), was not covered within the ambit of such FDI. To widen competition for investment into Air India, which is proposed to be put on the block soon as part of the disinvestment plan, the Government has also lifted the restriction barring foreign airlines from picking up stake in the national carrier. Now overseas players can acquire up to 49% stake in Air India subject to Government approval.

Earlier there was ambiguity on permissibility of FDI in companies engaged in ***real estate broking business.*** It has now been clarified that real estate broking services do not constitute real estate business and is therefore, eligible for 100% FDI under automatic route.

Previously, along with the 49% cap on FDI under automatic route in ***Power Exchanges***, FII/FPI purchases in this sector were restricted to secondary market only. Henceforth, FIIs/FPIs have been allowed to invest in Power Exchanges through the primary market as well.

Automatic route for holding/ investment activity: Previously, foreign investment into an Indian company engaged only in the activity of investing in the capital of other Indian companies and in Core Investing Companies was allowed up to 100% with prior Government approval. Henceforth, if such investment activities are regulated by any financial sector regulator, then FDI up to 100% will be allowed under automatic route; and if they are not regulated by any financial sector regulator or where only part is regulated or where there is doubt regarding the regulatory oversight, FDI will be allowed under Government approval route, subject to conditions including minimum capitalization requirement, as may be decided by the Government.

Competent Authority for examining FDI proposals from countries of concern: For investments through Automatic route requiring approval only on the matter of investment being from a country of concern, FDI applications shall be processed by Department of Industrial Policy & Promotion (DIPP), instead of the Ministry of Homes Affairs as was earlier the case. Cases under the Approval route also requiring security clearance with respect to countries of concern, will continue to be processed by concerned Administrative Department/Ministry.

Prohibition of restrictive conditions regarding audit firms**:** Henceforth, if a foreign investor wishes to specify a particular auditor or audit firm having an international network for an Indian investee company, then audit of such investee companies should be carried out as joint audit wherein one of the auditors should not be part of the same network. This change in policy, while improving corporate governance standards, will boost the business prospects of local chartered accountant firms.

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Ratio Decidendi

Composite Petition claiming rectification of register of shareholders as well as reliefs for oppression and mismanagement, maintainable

Key Points:

1. Composite Application for rectification of the register of members as well as reliefs for oppression and mismanagement is maintainable
2. The Tribunal can decide on a plea of forgery if it falls within the peripheral dispute of rectification.

Brief Facts:

A family was involved in the promotion of the 1st respondent company. The petitioner is the wife of the 2nd respondent and both were divorced in 2001. The petitioner had acquired 200 shares of the 1st respondent company from her personal savings and, therefore, claimed that the shares should be registered in her name despite the divorce. However, in 2013 the respondent no. 1 company illegally and fraudulently transferred the shares of the petitioner to respondent no. 3, thereafter striking off the petitioner's name from the register of shareholders of the company. In 2015, the petitioner made a representation to the respondent no.1 company asking them to hand over the share certificates, but the company did not respond. Thus, in 2016, she filed an application with the ROC, Madhya Pradesh complaining about the non-receipt of share certificates. Upon this complaint, the ROC advised Respondent No. 1 Company to address this grievance. Subsequently the petitioner, found that her shares had been illegally transferred to respondent no. 3 using forged documents, upon which she immediately filed an application with the ROC for correction of names in the register. She also claimed that the transfer was made by way of forged documents. The respondent company replied that the claim of the petitioner is false and stated that after the divorce, the petitioner had transferred these shares in lieu of valuable consideration from respondent no. 2. The petitioner further produced evidence to show that there was an unauthorized increase in the share capital and other instances that clearly pointed towards oppression and mismanagement and filed a composite application before the NCLT for rectification of the register as well as for reliefs against oppression and mismanagement.

Points for Consideration:

1. Whether a composite application for rectification of names in the register as well as for reliefs under Section 241 and 242 is maintainable or not?

Held: The Tribunal held that because the application made by the petitioner is one where she seeks rectification of the register in respect of the 200 shares that were held by her in the Respondent No. 1 company combined with some allegations regarding oppression and mismanagement, the petition is maintainable.

2. Whether the Tribunal can decide on the plea of forgery or the matter should be relegated to the Civil Court?

Held: The Tribunal cited the judgment of the Supreme Court in *Ammonia Supplies Limited* v. *Modern Plastic Corporation* and stated that if the dispute falls within the peripheral dispute of rectification, the Tribunal may exercise jurisdiction. However, due to the lack of availability of the instrument of transfer, the Tribunal decided against exercising jurisdiction over the matter.

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Order:

The petition was dismissed without any order as to costs. [*Sangeeta Maheshwari* v. *Premsagar Agricultural Private Limited* - 2017 (12) TMI 831]

Incorporation of an Arbitration Agreement by reference to a Standard Form

Key Points:

1. An Arbitration Agreement may be incorporated in a document by reference to a standard form.
2. The reference need not necessarily be by a trade union or a professional association.
3. The incorporation can however not be done by reference to an earlier contract/ agreement.

Brief Facts:

The appellant had issued two purchase orders to the respondent for the supply of cables for their Wind Turbine Generators. The standard terms and conditions attached to these purchase orders contained a term pertaining to dispute resolution, according to which, any dispute arising under the purchase orders was to be resolved by a sole arbitrator in accordance with the Arbitration and Conciliation Act, 1996. The respondent had agreed to all the terms and conditions of the purchase order except for the delivery period.

Pursuant to the purchase order, the respondents supplied to the appellant wind power cables, the outer sheaths of which were cracked. This forced the appellants to stop the wind turbine generator in order to avoid damage to the expensive machinery. The respondent company did not replace the cables and therefore the appellant issued a notice proposing the name of a sole arbitrator in accordance with the standard terms and conditions.

When the respondents did not respond to this notice, the appellants moved the High Court of Allahabad under Section 11(6) of the Arbitration and Conciliation Act, 1996, which was dismissed and therefore the appellants approached the Supreme Court of India.

Points for Consideration:

1. Whether a general reference to an earlier contract is enough for incorporation of an arbitration clause?

Held: The Court held that though a general reference to an earlier contract is not enough for incorporation of an arbitration clause, a general reference to a standard form would be sufficient for the incorporation of an arbitration clause. In the present case, though the purchase order and the terms of supply are different documents but because the terms of supply are a standard form, a general reference to it was sufficient for incorporation of the arbitration clause.

Order:

The appeal was allowed and the judgment of the High Court was set aside. [*Inox Wind Limited* v. *Thermocables Ltd.* - 2018 SCC OnLine SC 3]

Delivery of Demand Notice of an unpaid operational debt by a lawyer on behalf of operational creditor

Key Points:

1. The provision contained in Section 9(3)(c) of the Insolvency & Bankruptcy Code is discretionary and not mandatory in nature.
2. The demand notice of an unpaid operational debt can be issued by a lawyer on behalf of the operational creditor.

Brief Facts:

Three appeals with similar facts had been clubbed in this case. Hamera International Private Limited executed an agreement with the appellant, Macquarie Bank Limited, Singapore, on 27-7-2015, by which the appellant purchased the original supplier's right, title and interest in a supply agreement in favour of the respondent.

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The respondent entered into an agreement dated 2.12.2015 for supply of goods worth US$ 6,321,337.11 in accordance with the terms and conditions contained in the said sales contract. The supplier issued two invoices dated 21-12-2015 and 31-12-2015. Payment terms under the said invoices were 150 days from the date of bill of ladings dated 17-12-2015/19-12-2015. Since amounts under the said bills of lading were due for payment, the appellant sent several emails to the respondent for payment of the outstanding amounts. Ultimately, the appellant issued a statutory notice under Sections 433 and 434 of the Companies Act, 1956. A reply dated 5-10-2016 denied the fact that there was any outstanding amount.

After the enactment of the Code, the appellant issued a demand notice under Section 8 of the Code on 14-2-2017 at the registered office of the contesting respondent, calling upon it to pay the outstanding amount of US$ 6,321,337.11. By a reply dated 22-2-2017, the contesting respondent stated that nothing was owed by them to the appellant. They further went on to question the validity of the purchase agreement dated 27-7-2015 in favour of the appellant. On 7-3-2017, the appellant initiated the insolvency proceedings by filing a petition under Section 9 of the Code. On 1-6-2017, the NCLT rejected the petition holding that Section 9(3)(c) of the Code was not complied with, inasmuch as no certificate, as required by the said provision, accompanied the application filed under Section 9 of the Code. NCLAT agreed with the impugned judgment of the NCLT and dismissed the appeal. Therefore, the appellants approached the Supreme Court of India.

Points for Consideration:

1. Whether the provision contained in Section 9(3)(c) of the Insolvency and Bankruptcy Code is mandatory?

Held: It is amply clear that a copy of the certificate from the financial institution maintaining accounts of the operational creditor confirming that there is no payment of an unpaid operational debt by the corporate debtor is certainly not a condition precedent to triggering the insolvency process under the Code. The expression confirming makes it clear that this is only a piece of evidence*, albeit* a very important piece of evidence, which only confirms that there is no payment of an unpaid operational debt. Further, when compliance with Section 9(3)(c) becomes impossible in cases like the present, it would amount to a situation wherein serious general inconvenience would be caused to innocent persons, such as the appellant, without very much furthering the object of the Act and obviously, therefore, Section 9(3)(c) would have to be construed as being directory in nature.

2. Whether a demand notice of an unpaid operational debt can be issued by a lawyer on behalf of the operational creditor?

Held: It is clear that had the legislature wished to restrict such demand notice being sent by the operational creditor himself, the expression used would perhaps have been issued and not delivered. Delivery, therefore, would postulate that such notice could be made by an authorized agent. The position further becomes clear that both forms require such authorized agent to state his position with or in relation to the operational creditor. A position with the operational creditor would perhaps be a position in the company or firm of the operational creditor, but the expression in relation to is significant. It is clear, therefore, that both the expression authorized to act and position in relation to the operational creditor go to show that an authorized agent or a lawyer acting on behalf of a client is included within the aforesaid expression.

Order:

The NCLAT Judgment was set aside and the matter was remanded back to the NCLAT. [*Macquarie Bank Limited* v. *Shilpi Cable Technologies Ltd.* - C.A. No. 15135 of 2017, Judgment dated December 15, 2017]

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Application under Insolvency & Bankruptcy Code may also be made when a Company Court has admitted a winding-up petition

Key Points:

1. Before IBC was implemented, SICA was held to have predominance over the provisions of the Companies Act. Then, SICA was repealed and IBC was implemented instead. IBC essentially being SICA's replacement must understandably have primacy over the provisions of the Companies Act, 2013, or Companies Act, 1956.

Brief Facts:

The Appellant, an Operational Creditor, had on 10th March, 2015 filed a Company Petition under Sections 433 and 434 of the Companies Act, 1956, claiming that the Respondent owed the Appellant, outstanding sums in respect of unpaid invoices for goods supplied, and thereby sought a Winding-Up against the Respondent. The said Company Petition was admitted on 9th March 2017. However, an Official Liquidator was not appointed since all assets were secured and it was held that the Court would appoint one at a later stage if the need arose. On 19th June, 2015, during the pendency of the Winding-Up, the Respondent had made a reference to the BIFR under the SICA. Upon enactment of the IBC, SICA was repealed and all matters pending before the BIFR stood abated. However, liberty was granted to applicant companies to file cases afresh under the IBC. Accordingly, the Respondent filed an application before NCLT, Ahmedabad under Section 10 of IBC seeking initiation of the Corporate Insolvency Resolution Process within the prescribed window of 180 days on 29th March, 2017. The NCLT directed the same to be listed on 20th July, 2017. On the same day, the Appellant filed a Company Application in the Bombay High Court seeking the appointment of a Provisional Liquidator.

Points for Consideration:

1. Whether an application under the Insolvency and Bankruptcy Code can be made even after a company court has admitted a winding-up petition?

Held: It was observed that only under a transitional provision, winding up petitions retained by the High Court are being decided under the Companies Act, 1956. However, such a transitional provision must not take away the remedies available to a person in any manner under IBC vis-à-vis the company against whom a petition is filed and retained in the High Court. This would lead to consequences which would essentially amount to the same as ignoring the existence of IBC in the statute book. It would deprive persons of the benefit of the new legislation. Even in such a case, there is no express or implied bar from other creditors of such company or the corporate debtor from filing fresh proceedings under IBC.

Order:

The Bombay High Court has ruled that an application under IBC may even be made in cases where a Company Court has admitted a Winding-Up petition. However, in case the final order of Winding-Up is passed under Section 481 of the Companies Act, 1956, then such an application would not be permitted. [*Jotun India (Pvt) Ltd.* v. *PSL Ltd.* - Company Application No. 572 of 2017 in Company Petition No. 392 of 2016, Bombay High Court Order dated January 5, 2018]

Regulation 28 of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 not applicable in assignment deeds executed prior to insolvency resolution period

Key Points:

1. Under Section 21(2) of the IBC, the committee of creditors shall comprise all

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financial creditors, excluding the corporate debtor's related parties.

2. Regulation 28 of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 requires the interim resolution professional to be informed regarding assignment or transfer of debt amongst creditors during the insolvency resolution period.

Brief Facts:

Synergies Dooray was placed under insolvency proceedings in January 2017 as it owed its financial creditors Rs. 972.15 crore spread across four creditors. However, the insolvency plan approved by the committee of creditors involved paying its financial creditors only Rs. 50 crore. If the plan had not been approved in the mandated time-period, the company would have gone into liquidation. Synergies Casting, being a related party of Synergies Dooray had no voting rights in the committee of creditors. In the second meeting of the committee of creditors held on June 24, 2017, the resolution plan put forth by the related party was approved. As per Section 21(2) of the IBC, the committee of creditors should comprise all financial creditors, excluding the corporate debtor's related parties to which it owes money to prevent the related party of the corporate debtor from having any say in the committee of creditors. Therefore, in this case, Synergies Casting, which is a related party of Synergies Dooray, did not have any right on the committee of creditors.

One of the financial creditors contended that Synergy Castings had assigned 92.93% of its loan, to Millennium Finance in November 2016 before the initiation of insolvency proceedings. This transaction, which gave Millennium Finance 76.33% of the voting rights in the committee of creditors, is reported to have allegedly given Synergies Casting, through Millennium Finance, a back-door entry to capture majority voting rights in the committee of creditors, thereby, getting its resolution plan passed. The financial creditor challenged the resolution process as its voting rights in the committee of creditors drastically came down despite being one of the largest financial creditors, mainly because of such debt assignment agreement.

Point for consideration:

Whether a related party of the corporate debtor can sell off its loan to the company under insolvency to a third party?

Held: Assignment deeds between the two entities are legal and permissible. Due to this assignment deed, not only was the applicant's share in total debt reduced, but other financial creditors/Assignees share also proportionately reduced and they did not object to the same. Therefore, a fraudulent attempt made to reduce the Applicant's share in the total voting rights is not a plausible plea.

Order:

The financial creditor's appeal to scrap the debt recast plan was rejected by the NCLT. It has now approached the National Company Law Appellate Tribunal. [*Edelweiss Asset Reconstruction Company Limited* v. *Synergies-Dooray Automotive Limited and Ors.* - CA No. 124/2017 dated August 2, 2017 before NCLT, Hyderabad]

Limitation Act, 1963 is applicable to proceedings under the Insolvency & Bankruptcy Code, 2017

Key Points:

1. NCLAT held that the Limitation Act, 1963 is not applicable for initiation of 'Corporate Insolvency Resolution Process'.
2. The Doctrine of Limitation and Prescription is necessary to be looked into for determining the question whether the application under

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Section 7 or Section 9 can be entertained after long delay, amounting to laches and thereby the person forfeited his claim.

3. The Supreme Court considered the appeal against the order of the NCLAT and has stayed the remand made under the order, thereby implying that the Limitation Act, 1963 will be applicable to the Insolvency and Bankruptcy Code, 2017, as opposed to the observation of the NCLAT.

Brief Facts:

The Respondent is a private limited company incorporated under the Companies Act, 1956. The Appellant is a partnership firm of Chartered Accountants. The controversy emanates from falsification of accounts of the Respondent which was incorporated with authorized share capital of Rs 5 lakh and issued paid up capital of Rs. 1 lakh only. Based on favorable position shown by the Appellants of the Respondent company, an individual made investments in the Respondent company. He was later appointed director of the Respondent company before being unlawfully ousted from the said post. Debts were inflicted on the Respondent company where the family members of the Appellant came in control illegally and ultimately after ouster of all existing directors of the Respondent Company without following due procedure or even notifying them of the same, the Appellant and his brother became full time directors of the Respondent Company. Prior to coming into power, the Appellants increased the paid-up capital of the Appellant company from INR 5,00,000 to INR 10,00,00,000.

In addition to above, the Appellants issued notices for repayment of the amounts payable by the Respondent Company to them that had been extended as “loans”. It was basis these notices that the Appellants filed a Company Petition for recovery of their debt before the NCLT. On 25 April 2017, the NCLT passed its final order and held that the alleged loans claimed by the Appellants were barred by limitation. It was held that there was nothing on record that would extend the limitation to recover the purported debts advanced by the Appellants were advanced between 2012 and 2013. Subsequently, the Appellant preferred an appeal before the NCLAT. On 7th November 2017, the NCLAT passed final order stating that the Limitation Act, 1963 is not applicable for initiation of Corporate Insolvency Resolution Process.

Point for Consideration:

(i) Whether Limitation Act, 1963 is applicable for triggering 'Corporate Insolvency Resolution Process' under Insolvency and Bankruptcy Code, 2016 (hereinafter referred to as "I&B Code")?

Held: The scheme of I&B Code and the nature of the remedy provided therein are such that the Legislature intended it to be a complete code by itself to govern several matters provided by it. For initiation of 'Corporate Insolvency Resolution Process', the right to apply accrues under Section 7, Section 9 or Section 10 only with effect from December 1, 2016 when 'I&B Code' has come into force, therefore, the right to apply under Section 7, Section 9 or Section 10 in all present cases having accrued after 1st December 2016, such applications cannot be rejected on the ground that they are barred by limitation.

(ii) Whether a person can claim any amount due from another, a ‘Corporate Debtor’ after long delay on the ground that Limitation Act, 1963 is not applicable?

Held: While the Court held that the Limitation Act, 1963 is not applicable for initiation of ‘Corporate Insolvency Resolution Process’, it further held that the Doctrine of Limitation and Prescription is necessary to be considered for determining the question whether the application under Section 7 or Section 9 can be entertained after long delay, amounting to laches.

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Order:

The impugned order dated April 25, 2017 passed by the Adjudicating Authority was set aside and the case remitted back to the Adjudicating Authority. [*Parag Gupta & Associates* v. *B.K. Educational Services Pvt. Ltd.* - Company Appeal (AT) (Insolvency) No. 76 of 2017]

SEBI directions against fraudulent accounting practices perpetrated by an international firm ineffective if directions do not bring within its sweep the entire network of its operations

Key Points:

(i) "*Mens rea*" in the criminal sense of the term is not relevant to be established in cases of violation under the SEBI (PFUTP) Regulations read with applicable provisions under the SEBI Act.

(ii) The network structure of operations adopted by international accounting firms as prescribed under ICAI, should not be used as a shield to avoid legal implications arising out of the certifications issued under the brand name of the network.

Brief Facts:

Letter by Satyam directors: The Securities and Exchange Board of India ("SEBI") received an e-mail dated January 7, 2009 from the Chairman of Satyam Computer Services Limited ("SCSL"), admitting to large scale financial manipulations in the books of accounts of SCSL. Pursuant to the said communication(s), SEBI carried out an investigation into the affairs of SCSL to ascertain violations under the Securities and Exchange Board of India Act, 1992 ("SEBI Act") and rules and regulations framed thereunder. Upon thorough investigation, it was found that certain directors, employees of SCSL along with their statutory auditors had collaborated in the overstatement, fabrication, falsification and misrepresentation in the books of account and financial statements of SCSL. The statutory auditor of SCSL from April 1, 2000 were the noticees in the present case. On the basis of the findings of the investigation, a Show Cause Notice (**SCN**) dated February 14, 2009 was issued to all defaulting parties asking them to show cause as to why directions under the SEBI Act should not be issued against them for alleged violation of various provisions of the SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003 (PFUTP Regulations).

Writ petitions in the Bombay High Court: On February 14, 2009, a preliminary reply to the SCN was submitted by Noticee No. 1 i.e. statutory auditor, *inter alia,* denying involvement in any fraudulent and unfair trade practices as alleged in the SCN. It was further submitted that the directions contemplated in the notice were in the nature of partial suspension of the license to practice and such action, can only be taken by the Institute of Chartered Accountants of India (ICAI) and not by SEBI. Based on the said reasoning, the noticees filed writ petitions before the Hon'ble High Court of Bombay for quashing the proceedings initiated on the basis of aforesaid show cause notices. However, the High Court refused to admit the writ petitions and directed SEBI to proceed with the adjudication of the matter in accordance with law. Alternatively, the engagement partners of the statutory auditor (Noticee No. 12 & 13 in the SCN) filed another writ petition in the High Court of Bombay seeking an order to stay the proceedings instituted by SEBI, amongst other reliefs, till the conclusion of their criminal trials in the matter initiated by CBI. The Hon'ble High Court of Bombay, *vide* order dated February 27, 2012 directed SEBI to commence the proceedings pursuant to the SCNs against the said individual partners from the week commencing from May 7, 2012 and that if by then, the trial in criminal case did not get over, SEBI was to ensure that its dates of inquiry

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do not clash with the dates of the trial. Further, the individual partners were barred from issuing any certificate with respect to compliance obligation of any listed companies and registered intermediaries of SEBI or access securities market during the pendency of the proceedings before SEBI.

Supreme Court order on SLP filed by the Noticees: Special Leave Petition(s) were filed by these noticees before the Hon'ble Supreme Court against the said order of Hon'ble High Court of Bombay which was disposed of by the Hon'ble Court with the direction that the order passed by the High Court shall continue to operate for a period of (3) three months until after the final reply of the petitioner is received in the office of the first respondent. The Hon'ble Supreme Court in a separate petition filed by the partners also directed SEBI to grant an opportunity to the noticees to conduct inspection of all documents collected during the investigation. Pursuant to the said Supreme Court order, an inspection was carried out by the noticees for a period of one month which was followed by a cross-examination of witnesses by the notices which was concluded on September 14, 2017.

Reply to the SCN by Noticees: On November 10, 2017, Noticee No.1 sent a reply to the SCN which was adopted by the rest of the noticees. The noticees in their response stated that directions cannot be issued against them if there is only some omission without any *mens rea* or connivance with any one. The notices *inter-alia* points out that the SCNs fail to differentiate between the roles and responsibilities of SCSL's management and that of the statutory auditor, exaggerating the responsibilities of the statutory auditor. The applicable law and relevant auditing standards make it clear that SCSL's management and not the auditors are responsible for preparing the financial statements and for preventing fraud. In this regard, the statutory auditor relied on the Bombay High Court judgment in *Tri-Sure India Ltd.* v. *AF Ferguson & Co. & Other*[5], wherein it was settled that auditors must not be made liable for not tracking down ingenious and carefully laid schemes of fraud when there is nothing to arouse their suspicion, and where those frauds are perpetrated by trained servants of the company.

Analysis of the role of Statutory Auditors (PW) in SCSL:

Based on their analysis, SEBI accepted and admitted the fact, without doubt that the carefully laid out scheme of fraud and falsification of accounts in SCSL, gets attributed to the top management of SCSL by its own admission. However, SEBI feels that the perpetration of the fraud could not have been made possible without the knowledge and involvement of the statutory auditors. Since the accounting process has a tendency to interlink several facets of a company's operations, the falsification exercise which started with faking of invoices, was extended to inflation of debtors and receivables, boosting fake revenues as well as generation of book profits and false bank balances. These are vital points in a company's accounting process which presents the auditors with various opportunities to sit up and take notice.

All these lapses and several others, on the part of the statutory auditors, do throw up gaping holes in the auditing process followed by the auditors. SEBI placed reliance on the Andhra Pradesh High Court judgment elaborating on the duties of auditors in *ICAI* v. *Mukesh Garg*[6] wherein emphasis was laid on the term "*gross negligence*" and it was further stated that reckless certification by an auditor resulting in the public being misled into subscribing to the shares of the company in public issue, would

[5] (1987)61 Comp. Cas 584 (Bom)

[6] Referred Case No. 2 of 2011, decided on 26.09.2016

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undoubtedly amount to gross negligence. SEBI observed that in a public company, the duties assigned to an independent auditor are very crucial and pivotal since the certifications issued by the auditors have a definite influence on the minds of the investors. The auditors owe an obligation to the shareholders of a company to report the true and correct facts about its financials since they are appointed by the shareholders themselves. Therefore, based on the evaluation of the entire auditing exercise, SEBI believed that allegations in the SCNs cannot be said to be misplaced or unsubstantiated. Since SEBI was satisfied about the culpability of the auditors from the evidence, *mens rea* in the criminal sense of the term was not relevant to be established in a violation alleged under the SEBI (PFUTP) Regulations.

***"Rules of Network" formulated by ICAI**:*

All chartered accountancy firms (CA Firms) are required to be registered with the ICAI which has formulated "Guidelines for Networking". These rules enable the practice of CA Firms that are part of Indian or international networks on a sharing of resources basis. The said rules treat "*Networks*" as being an aggregation of firms which function as a consolidated unit. In the present case, it was observed that the brand holds its partner firms in a loose-knit network arrangement, enabling each firm to derive the advantages of the brand value and the synergy without laying down any supervisory mechanisms to check the quality of the performance of various firms under the network. In view of the same, SEBI was of the view that the directions in the instant case ought to be aimed at the particular network, that is responsible for the fraud in SCSL.

***SEBI directions**:*

Based on the factual matrix and the issues and contentions raised by both the parties, SEBI passed the following directions:

For a period of two years, entities/ CA Firms practicing under the brand and banner of the audit entity, shall not directly or indirectly issue any certificate of audit of listed companies, compliance of obligations of listed companies and intermediaries registered with SEBI.

The engagement partners shall not directly or indirectly issue any certificate of audit of listed companies, compliance of obligations of listed companies and intermediaries registered with SEBI.

The engagement partners along with the Bangalore entity shall be jointly and severally liable for the disgorgement of wrongful gains amounting to INR 13,09,01,664/- with interest calculated at the rate of 12% per annum from January 07, 2009 till the date of payment.

***Appeal to Securities Appellate Tribunal (SAT)**:*

The noticees have approached the SAT to challenge the jurisdiction of SEBI in adjudicating this matter. SAT *vide* Order dated January 19, 2018 has so far only confirmed an interim relief, stating that the noticee can continue to audit existing clients for the fiscal year 2017-18 or companies whose accounting year has begun from January 1, 2018. The next hearing in the matter has been scheduled for February 13, 2018

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