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Contents

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Articles

Indemnity clause in a Share Purchase Agreement

By **Anurag Pareek**

Introduction

Indemnity is the promise by one to compensate for any loss, liability or damage incurred by another due to an act or omission on the part of one or of some third person or an event. Section 124 of the Indian Contract Act, 1872 (Contract Act) defines a 'contract of indemnity' as a contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person. This, however, is not an exhaustive definition of indemnity and therefore, the indemnity clauses in share purchase agreements (SPAs) on principles of common law may have a wider scope than that provided under the Contract Act.[1]

Are indemnity clauses significant?

Usually, SPAs provide for an indemnity clause for management of risk of losses associated with the contract. Often heavily debated and negotiated upon in SPAs, these are relevant to the sellers seeking to limit future liabilities as well as the buyers aiming to cover themselves against any losses or liabilities that arise, primarily, out of inaccuracies of representations made by the seller during sale, or due to any event which might have occurred under the ownership of the seller, or due to an event which might occur post completion of sale, not necessarily dependent on the conduct of the seller. Given the antithetical interests of both parties and the profound effect indemnification provisions have on economics of the deal, indemnity clauses are crucial to M&A transactions.

Are indemnity clauses needed when statutory remedy for damages is available?

Critical to discussion is whether there lies a benefit in seeking indemnity instead of resorting to claiming damages[2] under the Contract Act. This can be understood by drawing a distinction between a claim of damages and that of indemnity with respect to:

a) **Parties to the claim**
A claim for damages under Section 73 of the Contract Act can be made only against the party that has made the promise under the contract. The existence of a concluded contract is a *sine qua non* in a claim for compensation for loss and damages under this section.[3]
However, the promisor's liability under indemnity provisions extends to losses or liabilities due to not just acts of the promisor but also the acts of a third party or upon the occurrence of any event. This extension is a major advantage that an indemnity clause has over a claim for damages.

b) **When losses can be claimed**
Damages for breach of a contract cannot be awarded until an actual loss is suffered since these are to compensate for the damage, loss or injury resulting from that

[1] Gajanan Moreshwar Parelkar v. Moreshwar Madan Mantri, 1942 SCC OnLine Bom 29.

[2] Section 73 of the Indian Contract Act, 1872.

[3] Vedanta Limited v. Emirates Trading Agency LLC, 2017 SCC OnLine SC 454.

breach.[4]

Whereas, the courts in India have taken the position that an indemnity holder is entitled to claim indemnification on mere accrual of liability, that is, before incurring any actual damage or loss and that an indemnity is not necessarily invoked after payment.[5] The discharge of the same, however, can be contractually agreed upon between the parties.

c) **Duty to mitigate damages**

Section 73 imposes upon the plaintiffs, an obligation to take reasonable steps to minimise loss and to refrain from taking unreasonable steps that would increase the loss.[6] No such obligation arises in case of an indemnity clause unless the contract expressly provides for it.

d) **Reasonability, foreseeability and remoteness of damages**

A claim for damages is subject to the rules of reasonability, foreseeability and remoteness. The rationale behind allowing damages for breach of a contract is to enable restoration of the economic position in which the injured would have been had the breach not taken place.[7] Therefore, the damages must be commensurate with the injury sustained. Similarly, it must be established that the damages are a direct consequence of the breach[8] and were reasonably foreseeable at the time of contracting.[9]

However, these principles of reasonability, foreseeability and remoteness are not applicable to an indemnity clause, enabling the indemnified party to demand through a broader range of claims, consequential and remote losses, provided they are not expressly excluded in the contract.

Limitation of liability and its advantage to the seller

Indemnification clauses under SPAs also regulate the limitations and the exceptions to the seller's liability in respect of the claims made by the purchaser. A limitation of liability clause is the exculpatory clause that sets forth certain limitations of time and money in case an indemnity claim arises.

The ability of the purchaser to bring a claim against the seller for indemnification is generally bound by a period defined in the SPA. Similarly, the monetary liability of the seller can be restricted to the purchase price or a percentage of the purchase price under the SPA.

In addition to an upper threshold, it is also possible to set differential thresholds depending on the nature of the breach. A seller's liability can also be limited by stipulation of minimum losses that must be incurred before the seller can be made liable. A provision for aggregation of claims can also be made under the SPA, wherein the purchaser assumes the risk until it exceeds a certain predetermined amount and it is then that the claim is made against the seller.

Conclusion

Indemnity clauses are the inherent tools to protect a purchaser's interests in event of breach of the representations and warranties given by the seller under the SPA. In addition to contractual breaches by the seller, an indemnity clause also protects a buyer from any action of a third party or the occurrence of any event which

[4] Maharashtra State Electricity Board v. Sterlite Industries (India) Ltd., 2000 SCC OnLine Bom 89.
[5] Jet Airways (India) Limited v. Sahara Airlines Limited, 2011 SCC OnLine Bom 576.
[6] Manju Bagai v. Magpie Retail Limited, 2010 SCC OnLine Del 3842.
[7] BR Herman and Mohatta v. Asiatic Steam Navigation Co. Ltd., AIR1941 Sind 146.
[8] Pravudayal Agarwala v. Ram Kumar Agarwala, 1954 SCC Online Cal 66; Hadley v. Baxendale, (1854) 9 Exch 341.
[9] State of Kerala v. K Bhaskaran, 1984 SCC OnLine Ker 198; Hadley v. Baxendale, (1854) 9 Exch 341.

may or may not happen prior to the closing date under the SPA.

Simultaneously, the seller's interests are protected as his liability is limited by time and monetary constraints. Indemnity clauses also regulate, among other things, purchaser's obligations regarding treatment of breaches before they are notified to the seller, purchaser obligations in case of third party claims, the procedure for claiming indemnification, exceptions to seller's liability etc.

Damages, on the other hand, are the alternate remedy available under the Contract Act. Damages so awarded, as discussed above, put the purchaser at a significant disadvantage as several conditions restricting the scope of damages, that can be claimed, are imposed on the claimant statutorily. Additionally, absence of a cap on damages that can be claimed exposes the seller to uncertain liability. It is therefore, that this allocation of risks and liabilities by an indemnity clause in an SPA, provides certainty to the transaction as exposure of either party to the transaction is defined.

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Corporate Insolvency Resolution Proceedings under IBC are independent of winding-up proceeding under Companies Act, 1956

By **Ankit Parhar**

In *Forech India Ltd. v. Edelweiss Assets Reconstruction Co. Ltd.*[10], the Supreme Court has held that an Insolvency Petition may be filed against a corporate debtor irrespective of the pendency of a winding-up petition before a High Court

The facts before the Supreme Court were that an Operational Creditor ("OC1") had filed a winding-up petition under Section 433(e) of the Companies Act, 1956 ("Companies Act") before the Delhi High Court against the Corporate Debtor ("CD"). While the winding-up petition filed by OC1 was pending, another Operational Creditor ("OC2") filed an insolvency petition under Section 9 of the Insolvency and Bankruptcy Code, 2016 ("IBC") against the CD. Subsequently, the insolvency petition filed by OC2 was withdrawn so that it could file a separate winding-up petition and have the same heard along with the winding-up petition filed by OC1.

Meanwhile, a Financial Creditor ("FC") filed an insolvency petition against the CD under Section 7 of the IBC. The said petition was admitted by the National Company Law Tribunal, New Delhi ("NCLT"). OC1 challenged the order of the NCLT before the National Company Law Appellate Tribunal ("NCLAT"). The NCLAT referred to Section 11(d) of the IBC which inter alia provides that a corporate debtor in respect of whom a liquidation order has been made is not entitled to make an application to initiate corporate insolvency resolution process ("CIRP") and held that the petition filed by the FC would be maintainable as no winding-up order had been passed by the High Court.

OC1 challenged the order of the NCLAT before the Supreme Court. OC1 argued that the

[10] Civil Appeal No. 818 of 2018 decided on 22nd January 2019.

winding-up petition filed by it would be saved by Rule 5 of the Companies (Transfer of Pending Proceedings) Rules, 2015 as notice was issued on the winding-up petition much prior to the commencement of the IBC. The FC argued that the whole object of the IBC would be frustrated if petitions for winding-up were to continue in the face of insolvency petitions under the IBC. The FC also argued that the objective of the IBC is to infuse life into a corporate debtor who is in the red, and it is only if the CIRP fails that liquidation takes place.

The Supreme Court referred to the amendments to Section 434 of the Companies Act brought into force by Section 255 of the IBC read with the Eleventh Schedule which relate to the transfer of proceedings to the NCLT. The Supreme Court also referred to the proviso added to Section 434 of the Companies Act w.e.f. 17.08.2018 which provides that any proceedings relating to the winding-up of companies pending before any Court immediately before the commencement of the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018, may file an application for transfer of such proceedings and the Court may by order transfer such proceedings to the NCLT and the proceedings so transferred shall be dealt with by the NCLT as an application for initiation of CIRP under the IBC. The Supreme Court further referred to Rule 26 and 27 of the Companies (Court) Rules, 1959 which provide for the service of petitions and notice of petitions and the time of service.

The Supreme Court noted that there was a divergence of the views expressed by the Bombay High Court in *Ashok Commercial Enterprises v. Parekh Aluminex Ltd.*[11] and the Madras High Court in *M/s. M.K. & Sons Engineering v. Eason Reyrolle Ltd.*[12] inasmuch as the Bombay High Court had held that the notice referred to in Rule 26 was a pre-admission notice and hence, held that all winding-up petitions where pre-admission notices were issued and served on the Respondent would be retained in the High Court and the Madras High Court had held that the notice referred to in Rule 26 was a post-admission notice and hence only those petitions where a winding-up order is already made can be retained in the High Court.

The Supreme Court held that Rules 26 and 27 clearly refer to a pre-admission scenario and that the view of the Bombay High Court is correct in law. The Supreme Court also approved the decision of the Bombay High Court in *PSL Ltd. v. Jotun India Pvt. Ltd.*[13] wherein it was held that the transitional provisions could not affect the remedies available to a person under the IBC against a company in respect of which a winding-up petition has been retained by a High Court.

In this background, the Supreme Court held that the reasoning of the NCLAT based on Section 11(d) of the IBC was not correct as Section 11(d) is of limited application and only bars a corporate debtor from initiating voluntary CIRP under Section 10 of the IBC if a liquidation order has been made in respect of such corporate debtor. The Supreme Court referred to its earlier judgment in *Jaipur Metals & Electricals Employees Organization v. Jaipur Metals & Electricals Ltd.*[14] and concluded that proceedings under the IBC are independent proceedings having nothing to do with the transfer of pending winding-up proceedings before a High Court and it is open to any creditor to approach the NCLT under the IBC before a winding-up order is passed.

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[11] (2017) 4 Bom. CR 653

[12] in CP/364/2016

[13] (2018) 2 AIR Bom. R. 350

[14] Civil Appeal No. 12023 of 2018 decided on 12th December 2018

However, the Supreme Court declined to interfere with the ultimate order passed by the NCLAT as the FC's petition before the NCLT was an independent proceeding which is to be decided in accordance with the IBC. The Supreme Court also granted OC1 liberty to seek transfer of the winding-up petition pending before the Delhi High Court to the NCLT under the proviso to Section 434 of the Companies Act as amended w.e.f. 17.08.2018.

Many issues have arisen due to the divergent views taken by different High Courts regarding the interpretation of the transitional provisions. Moreover, the so-called *conflict* between the IBC and the Companies Act has been a bone of contention for some time. This judgment finally settles the position and provides much needed clarity on these aspects.

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Notifications and Circulars

Revision of ECB framework: The Reserve Bank of India (RBI) on December 17, 2018 revised and consolidated the provisions related to borrowing and lending transactions into one single regulation i.e. the Foreign Exchange Management (Borrowing and Lending) Regulations, 2018 ("ECB Regulations"). In alignment with the ECB Regulations, and to rationalize the extant framework for External Commercial Borrowings ("ECB") and Rupee Denominated Bonds ("RDB"), the RBI laid down new ECB guidelines *vide* A.P. (DIR Series) Circular No. 17 dated January 16, 2019 ("New ECB Framework"). The salient features of the New ECB Framework are as under:

(a) ***Merging of Tracks:*** The New ECB Framework replaces the three-tier track system by consolidating and distinguishing ECB(s) based on currency denomination. Whereas, FCY denominated ECB includes ECB denominated in freely convertible foreign currency with a Minimum Average Maturity Period (MAMP) of three years, INR denominated ECB includes ECB denominated in Indian rupees with an MAMP of three years which also includes plain vanilla RDB(s). As a result of the merging of ECB tracks, a single all-in-cost ceiling has been stipulated for all ECB(s) including RDB(s) to determine costs for borrowings.

(b) ***Eligible Borrowers:*** The list of eligible borrowers has been expanded to include all entities eligible to receive FDI. Additionally, Port Trusts, Units in SEZ, SIDBI, EXIM Bank, registered entities engaged in micro-finance activities, viz., registered not for profit companies, registered societies/trusts/cooperatives and non-government organisations can also borrow under this framework. The eligible borrowers/category of borrowers may raise ECB of up to USD 750 million or equivalent per financial year under the automatic route replacing the existing sector wise limits.

(c) ***Recognised Lender:*** Any resident of FATF or IOSCO compliant country can be recognized as a lender. Further, multilateral and Regional Financial Institutions, Individuals and Foreign branches / subsidiaries of Indian banks can also be lenders.

(d) ***MAMP:*** Irrespective of the amount of borrowing, a uniform MAMP of 3 years is stipulated for all ECBs. In case of ECB raised from a foreign equity holder, the MAMP stipulated is 5 years subject to the condition that ECB proceeds are utilised for certain specific purposes. Special dispensation is given to ECB raised up to USD 50 million per financial by entities in the manufacturing sector, wherein the MAMP stipulated is 1 year.

(e) ***Late Submission Fee ("LSF"):*** This facility provides an opportunity to the borrower to regularize the delay in reporting drawdown of ECB proceeds subject to fulfilment of conditions stated in the New ECB Framework.

Companies (Acceptance of Deposits) Rules, 2014 amended: The Ministry of Corporate Affairs ("MCA") *vide* notification dated January 22, 2019 ("Amendment") has amended the provisions of the Companies (Acceptance of Deposits) Rules, 2014 ("Deposit Rules"). The significant changes and reporting requirement introduced by the Amendment is stated hereunder:

(i) Any amount received by a company from Real Estate Investment Trusts shall be excluded from the definition of "*deposits*".

(ii) Explanation to Rule 16 of the Deposit Rules has been incorporated to clarify that Form DPT-3 shall be used to file return of deposit as well as particulars of transaction not considered as deposits. The aforesaid reporting requirement is required to be fulfilled by every company other than a Government company;

(iii) Rule 16A (3) mandates every company other than a Government company to file a one-time return in Form DPT-3 to report any outstanding receipt of money or loan considered as "deposits" or any such receipt specifically excluded from the definition of "deposits" under Rule 2 (1)(c) of the Deposit Rules.

(iv) The one-time return in Form DPT-3 shall be filed within a period of 90 (ninety) days from the date of notification i.e. *January 22, 2019* for the period between April 1, 2014 till the date of this Notification.

Specified Companies (Furnishing of information about payment to Micro and Small enterprise suppliers) Order, 2019: Section 405 of the Companies Act, 2013 grants the Central Government the power to direct companies in general or a specific class of companies, to furnish such information or statistics as is specified in the Order. In exercise of its powers, as stated above, the Central Government has issued the Specified Companies (Furnishing of information about payment to micro and small enterprise suppliers) Order, 2019 *vide* Notification No. S.O. 368(E) dated January 22, 2019 ("Order"). The Order identifies "*Specified Companies*" as companies who procure goods or services from micro and small enterprises ("MSME") with outstanding payments exceeding 45 (forty-five) days from the date of acceptance or deemed acceptance of the goods or services.

The Order directs Specified Companies to submit a half yearly return to the MCA in MSME Form-I which provides for information such as the amount of payment due and the reasons for the delay in making payment. Further, every Specified Company shall be required to file details of all outstanding due to MSME suppliers as on the date of the Order, within 30 (thirty) days of its publication i.e. within 22 February 2019.

Dematerialization of securities by unlisted public companies: Rule 9A of the Companies (Prospectus and Allotment of Securities) Rules, 2014 requires every unlisted public company to issue securities in dematerialised form and facilitate the dematerialisation of its existing securities in accordance with provisions of the Depositories Act, 1996 and regulations made thereunder.

The MCA notified the Companies (Prospectus and Allotment of Securities) Amendment Rules, 2019 *vide* Notification No. G.S.R. 43(E) dated January 22, 2019 to introduce sub-rule (11) which exempts an unlisted public company which is a (i) Nidhi company; or a (ii) Government company or (iii) a wholly owned subsidiary from the provisions of this Rule 9A of Companies (Prospectus and Allotment of Securities) Rules, 2014.

SEBI (Prohibition of Insider Trading) (Amendment) Regulations, 2018: The Securities and Exchange Board of India (SEBI) has through a Gazette Notification dated 31.12.2018 published the Securities and Exchange Board of India (Prohibition of Insider Trading) (Amendment) Regulations, 2018 ("Amendment Regulation") which amends the existing SEBI (Prohibition of Insider Trading) Regulation, 2015 ("Insider Trading Regulations"). The amended Insider Trading Regulations will come into effect on 01.04.2019. These changes have been made pursuant to the report prepared and submitted by the Committee on Fair Market Conduct under the chairmanship of Mr. T.K. Viswanathan. We briefly discuss below the key changes to the Insider Trading Regulations –

i. ***Change to the definition of 'Unpublished Price Sensitive Information':*** The sub-clause "*(vi) material events in accordance with the listing agreement*" has been deleted from the definition of Unpublished Price Sensitive Information thereby clarifying that all material information may not necessarily be price sensitive.

ii. ***Defined 'Financially Literate':*** For the purpose of appointing Compliance Officer under Regulation 2(1)(c), the requirement of 'financially literate' that existed has now been defined for greater clarity. 'Financially literate' shall mean a person who has the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows.

iii. ***Applicability of the Insider Trading Regulations:*** The definition of 'proposed to be listed' has been added which clarifies the applicability of the Insider Trading Regulations on unlisted companies proposing to list their securities.

iv. ***Definition of 'Legitimate Purpose' and Policy for determination thereof***: Under Regulation 3, definition of what would constitute a legitimate purpose has been added along with the requirement of the Board of the Company to frame a policy to determine legitimate purposes.

v. ***Permitted Trading when in possession of unpublished price sensitive information***: This is one of the most key changes brought about by the Amendment Regulations as they widen the scope of permitted trading when in possession of UPSI not only in terms of the persons carrying out such trading but also the channels by which such permitted trading can be conducted. The earlier exemption of sorts that applied to promoters is now substituted by 'insiders' and new routes of permitted trading have been notified. In addition to above, presumably to dilute the effect of the newly widened scope, an explanation to Regulation 4(1) has been added stating "*When a person who has traded in securities has been in possession of unpublished price* *sensitive information, his trades would be presumed to have been motivated by the knowledge and awareness of such information in his possession*".

vi. ***Additional Compliances and Code of Conduct*:** Certain minimum internal controls have been notified vide insertion of Schedule - C under Regulation 9. The Schedule – C sets out minimum standards for code of conduct for intermediaries and fiduciaries to regulate, monitor and report trading by designated persons. Apart from the Code of Conduct for intermediaries, a Code of Conduct is also to be formulated by the boards of listed companies. In addition to this, listed companies must maintain a structured digital database with details such as PAN number and other identifying information of persons receiving UPSI. The amendments also state that mere formulation is not adequate and regular review and audits on the status of effective implementation of these internal controls must also be undertaken and recorded. Further, a whistleblower policy must be in place to by every listed company/board of such company for looking into any case of leak of UPSI.

Ratio Decidendi

Corporate Insolvency Resolution Process cannot be initiated against two separate corporate guarantors for same claim amount

Brief facts

A Deed of Agreement was executed between All India Association for Advance Education and Research ("Principal Borrower") and M/s. Piramal Enterprises Limited ("Financial Creditor") for grant of loan amounting to INR 38,00,00,000/- (Rupees Thirty-Eight Crores Only). The aforesaid loan amount was guaranteed by two Corporate Guarantors i.e. *Sunrise Naturopathy and Resorts Private Limited* ("Corporate Guarantor No. 1") and '*Sunsystem Institute of Information Technology Private Limited*'-("Corporate Guarantor No. 2"). The loan was disbursed in two tranches by the Financial Creditor to the Principal Borrower. Between January 2014 to July 2017, the Principal Borrower approximately repaid an amount exceeding INR 22,00,00,000/- (Rupees Twenty-Two Crores Only). Meanwhile, the financial creditor, filed a civil suit before the Court of Additional District Judge-I, Alwar, Rajasthan against the Principal Borrower and both the Corporate Guarantors which is pending adjudication.

During the pendency of this suit, the Financial Creditor issued separate demand notices to the Corporate Guarantors calling upon each of them to make payment of the outstanding amount amounting to INR 40,28,76,461/- (Forty Crores Twenty-Eight Lakhs Seventy-Six Thousand Four Hundred and Sixty-One Rupees Only) within 15 (fifteen) days of receipt of such notice. Thereafter, the Financial Creditor filed two separate applications under Section 7 of the Insolvency and Bankruptcy Code, 2016 ("IBC") for initiation of 'Corporate Insolvency Resolution Process' (CIRP) against Corporate Guarantor No. 1 and Corporate Guarantor No. 2 respectively which was subsequently admitted by the National Company Law Tribunal ("NCLT") by order dated May 31, 2018 and May 24, 2018. On perusal of records, including Form-1 filed by the Financial Creditor in both the applications, it is clear, that the same claim amount has been shown in both Form-1, and reliance has been placed on the same deed of agreement. Given the aforesaid background, the appellant raised questions on the maintainability of CIRP(s) initiated by the Financial Creditor.

Issues

(i) Whether 'Corporate Insolvency Resolution Process' can be initiated against a Corporate Guarantor if the 'Principal Borrower' is not a 'Corporate Debtor' or 'Corporate Person'?

(ii) Whether 'Corporate Insolvency Resolution Process' can be initiated against two 'Corporate Guarantors' simultaneously for the same set of debt and default?

Observations

The NCLAT, placed reliance on the Supreme Court judgement in *Bank of Bihar v. Damodar Prasad (1969) 1 SCR 620*. In the aforesaid case, the court referred to Section 128 of the Indian Contract Act, 1872, which states that the liability of the surety is co-extensive with the liability of the principal debtor. Therefore, the surety becomes liable to pay the entire amount immediately once the debt comes into existence. The liability of the surety is not deferred until the creditor exhausts his remedies against the principal debtor. In view of the above, it was held that, it is not necessary to initiate CIRP against the Principal Borrower before initiating CIRP against the Corporate Guarantors under Section 7 of the IBC.

With respect to the claim amount of debt and date of default etc., the Court observed that two separate applications under Section 7 of the IBC was preferred by the Financial Creditor against the Corporate Guarantors. To address this issue the NCLAT relied on the Supreme Court Judgement in *Innoventive Industries Ltd. v. ICICI Bank and Ors,* [(2018) 1 SCC 407]. Although, the IBC does not bar the Financial Creditor from filing simultaneously two applications to initiate CIRP against the Principal Borrower as well as the Corporate Guarantor(s), the admittance of application to initiate CIRP by the adjudicating authority against one of the Corporate Guarantor should result in the second application being disallowed by the adjudicating authority, if the application has the same set of claim and default. Since the debt in question is identical between both guarantors and the claim is the exact same, the appellants cannot proceed against both Corporate Guarantors separately.

For the aforesaid reasons, the NCLAT upheld the initiation of CIRP initiated under Section 7 of the IBC against Corporate Guarantor No. 2, however CIRP initiated under Section 7 of the IBC against Corporate Guarantor No. 1, for the same claim/debt was held to be not maintainable under the provisions of the IBC and therefore dismissed. [*Dr. Vishnu Kumar Agarwal* v. *Piramal Enterprises Ltd.* - National Company Law Appellate Tribunal Company Appeal (AT) (Insolvency) No. 346 of 2018, decided on 08-01-2019]

Put/buy-back option for equity investments comes within the meaning of 'financial debt'

Brief facts

On August 20, 2009, IL & FS Financial Services Limited (Hereinafter, referred to as "Financial Creditor" or "IL &FS") executed a Share Purchase Agreement ("SPA") with Multi Commodity Exchange of India Limited ("MCX") with respect to shares held by MCX in MCX Stock Exchange Limited ("MCX-SX"). Simultaneously, a Letter of Understanding ("LoU") was executed between La-Fin Financial Services Private Limited ("La-Fin" or the "Corporate Debtor" in the present case) and IL & FS, wherein La-Fin, being the promoter of MCX-

SX undertakes to purchase shares held by IL&FS in MCX-SX any time between one to three years from the date of SPA at a price (i) that would provide an internal rate of return (“IRR”) of 15% on IL&FS’s investment, or (ii) the price at which most recent transaction of MCX-SX shares was undertaken by the MCX group.

Subsequently on November 20, 2009, IL&FS received a notice for Extraordinary General Meeting by MCX-SX scheduled to be held on December 15, 2009 for consideration to pass a special resolution for "*Scheme of Reduction*" of MCX-SX’s share capital. The rationale for the aforesaid scheme of reduction was to comply with the requirements specified in Securities Contracts (Regulation) (Manner of Increasing and Maintaining Public Shareholding in Recognized Stock Exchanges) Regulations, 2006 ("MIMPS Regulations"). To ensure IL&FS’s interests as a shareholder of the Company and to compensate losses resulting from the reduction of shareholding, MCX Group requested IL&FS *vide* letter dated December 14, 2009 to approve the resolution, on the condition that MCX shall call the warrants issued in favor of IL&FS to be purchased immediately upon the approval of the Scheme of Reduction and in any event before March 31, 2010 and that the said letter and the terms thereof shall not in any manner dilute the terms of the SPA or the LoU. Based on the aforesaid undertaking, IL&FS accorded its consent for the resolution passing the scheme which was subsequently sanctioned by the High Court of Bombay by order dated March 12, 2010. As stated, MCX duly purchased the warrant(s) issued in favor of IL&FS for the extinguished shares.

Parallelly, MCX filed a writ petition against Securities Exchange Board of India (“SEBI”) on the issue that the whole-time member of SEBI rejected an application filed by MCX for permission to undertake business as a stock exchange, other than for the currency derivatives segment. The Bombay High Court’s order dated March 14, 2012 on the aforesaid writ petition, inter alia discussed on the legality of buyback agreements entered by MCX with Punjab National Bank and IL&FS.

The dispute leading to the present case arose when MCX, basis the aforesaid Bombay High Court Order issued a letter dated August 23, 2010, stating that the obligations under the LoU became infructuous and the Board of Directors of La-Fin passed a resolution declining to honor any buy-back or other similar arrangement. Notwithstanding several correspondences between IL&FS and MCX, a civil suit (Suit No. 449/2013) was filed against the Corporate Debtor by IL&FS seeking specific performance of Corporate Debtor’s obligations under the LoU.

Further, IL&FS issued a statutory demand notice on November 3, 2015 under Section 433 & 444 of the Companies Act, 1956 calling upon the Corporate Debtor to pay the outstanding debt of INR 232,50,00,000/- along with further interest of 15% per annum on the amount invested by IL&FS in respect of MCX shares. The Corporate Debtor denied the payment stating that the matter was sub-judice on account of civil-suit pending before the Bombay High Court for specific performance.

Basis the aforesaid factual background, IL&FS filed a winding-up petition under the erstwhile Companies Act, 1956 against the Corporate Debtor, however during the pendency of the matter, the petition was transferred to NCLT in accordance with notification dated June 29, 2017.

Issues for consideration

1. Existence of a “financial debt” on account of the relationship between the IL&FS and La-Fin pursuant to the buyback arrangement between the Parties.

2. Whether the petition filed by IL&FS under the erstwhile provisions of the Companies Act/ IBC is barred by limitation?
3. Whether the application under Section 7 of the IBC stands abated on failure by applicant to file Form-I within the stipulated time period?

Observations

Financial Debt – The NCLAT held that the amount disbursed by IL&FS falls within the meaning of 'financial debt' having disbursed against the "time value of money". The NCLAT relied on Section 5(8) of the IBC which defines *"financial debt" means a debt along with interest, if any, which is disburse against the consideration for the time value of money and includes- … (f) any amount raised under any transaction, including any forward sale or purchase agreement, having the commercial effect of borrowing.* It is observed by NCLAT that the transaction between IL&FS and La- Fin to reverse the transaction by purchasing shares within specified time along with payment of 15% IRR was made with the objective of making economic gain and had the commercial effect of borrowing. These provisions clearly bring out the element of 'time value of money'. Therefore, it was held that the amount disbursed by IL&FS the meaning of 'financial debt' and therefore IL&FS has been rightly claimed to be a '*Financial Creditor*' in Form-1 filed under Section 7 of the IBC.

Limitation - Basis the frequent correspondences between the parties up until November,2015 wherein the Corporate Debtor replied to the legal notice sent by IL&FS intimating about the pending suit, the NCLAT stated there exists a continuous cause of action and observed that the Corporate Debtor never raised the question of limitation, even in its response to the legal notice. There being a continuous cause of action, the NCLAT held that the application was not barred by limitation and the Corporate Debtor cannot take plea that there is no debt payable in law.

Abatement – Tracing the different notifications issued by the Central Government from time to time, the NCLAT observed that Rule 5 of the Companies (Transfer of Pending Proceedings) Rules, 2016 ("**Transfer Rules**") discusses about the transfer of pending proceedings of winding-up on the ground of inability to pay debts. The aforesaid rules states that all information other than the information forming part of records transferred including the details of the proposed insolvency professional is to be placed by Petitioner before the Tribunal within 60 days of the notification, for admitting petition under Sections 7, 8 or 9 of the IBC. It is in the said background that the counsel of the Corporate Debtor has taken plea Form 1 with the name of the 'Resolution Professional' was not filed within the stipulated time, however Rule 5 of Transfer Rules issued by Notification dated December 7, 2016 was subsequently amended by Notification dated February 28, 2017. Relying on the decision of the Supreme Court in Zile Singh v. State of Haryana and Others [(2004) 8 SCC 1], the NCLAT held that the case of the appellants is covered by the notification dated June 29, 2017 and having filed Form-1 on May 25, 2017 immediately after transfer of the case, the petition under Sections 433 & 434 of the erstwhile Companies Act, 1956 was not abated. Accordingly, the NCLAT dismissed both appeals without cost. [*Pushpa Shah and Ors.* v. *IL&FS Financial Services Limited and Ors.* - National Company Law Appellate Tribunal, Company Appeal (AT) (Insolvency) No. 521 of 2018, decided on 21-01-2019]

News Nuggets

Creditor Bank blowing hot hotter when also pursuing second remedy - SC: Supreme Court has held that creditor is not blowing hot and cold but hot and hotter when also pursuing a second remedy for realization of the same debt. Court in *Swaraj Infrastructure v. Kotak Mahindra* ruled that creditor bank can pursue winding-up petition under Companies Act after obtaining recovery certificate under Recovery of Debts Act. Court decision in the case of *Lissenden v. C.A.V. Bosch, Ltd.* was relied on. It was also held that under Section 439 of the Companies Act, a secured creditor's winding up petition is maintainable without relinquishing its security.

Insolvency and Bankruptcy Code is constitutionally valid – SC: Supreme Court has upheld constitutional validity of various provisions of Insolvency and Bankruptcy Code, 2016. It noted that the Code is a beneficial legislation which puts corporate debtor back on its feet, not being a mere recovery legislation for creditors. Court in *Swiss Ribbons (P) Ltd. v. UOI* held that classification between financial creditor and operational creditor is neither discriminatory, nor arbitrary, nor violative of Article 14 of the Constitution of India. It observed that there is intelligible difference between financial creditors and operational creditors.

High Court to be more circumspect in blocking investigation carried by DG CCI: Supreme Court has held that High Court should be more circumspect before it. restrains an investigation under the statutory authority of the Director General of Competition Commission of India. Court in *CCI v. JCB India Ltd.,* concerning an investigation of CCI on abuse of dominance by JCB, vacated the interim injunction of High Court which restrained CCI from utilizing the material seized after obtaining authorisation by the magistrate under Section 240A of the Companies Act. It also held that Section 240A do not merely relate to authorisation for search but to authorisation of seizure as well.

Company seeking voluntary removal under Section 248(2) be treated sympathetically: NCLAT has held that a company seeking voluntary removal of its name from register of companies should be treated sympathetically by the Registrar and should not be resisted from taking benefits of provisions under Section 248(2) or Condonation of Delay Scheme, 2018. NCLAT in *Cayenne developments v. RoC* allowed appellant after filing overdue documents to be treated as to have voluntarily removed its name from the register under Section 248(2) instead at the instance of Registrar under Section 248(1). Delhi High Court decision in *Sandeep Singh v. RoC* was relied on.

Insolvency proceeding against guarantor without exhausting debtor: Relying on Supreme Court judgement in SBI v. Indexport, NCLAT has held that it is not necessary to initiate Corporate insolvency resolution proceedings (CIRP) against the Principal borrower before initiating CIRP against the Corporate guarantors. CIRP was initiated against the corporate guarantor when principal borrower defaulted in repayment of loans and was declared an NPA. In *Ferro Alloys v. Rural Electrification Corporation Ltd.,* the respondent had sanctioned loan to FACOR Power Ltd. while Appellant pledged its shares as corporate guarantor. Tribunal noted that guarantor comes within meaning of 'corporate debtor'.

Mere delay in passing of award cannot be a ground to appoint new arbitrator: Supreme Court has held that the mere delay in passing of arbitration award cannot be a ground to appoint a new arbitrator. High Court Order appointing a substitute arbitrator in deviation from terms agreed by the parties, was set aside. Court in *Raj. Small Indus. Corp. v. Ganesh Containers Movers Syndicate,* where High Court had set aside appointment of appellant's MD as sole arbitrator in agreement with parties, set aside the High Court Order observing absence of evidence to prove impartiality. Section 12(5) of Arbitration Act, after amendment in 2015 was held not applicable as proceedings began in 2009.

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